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An Analysis of the President's Budgetary Proposals for Fiscal Year 1988

Prepared at the Request of the Senate Committee on Appropriations

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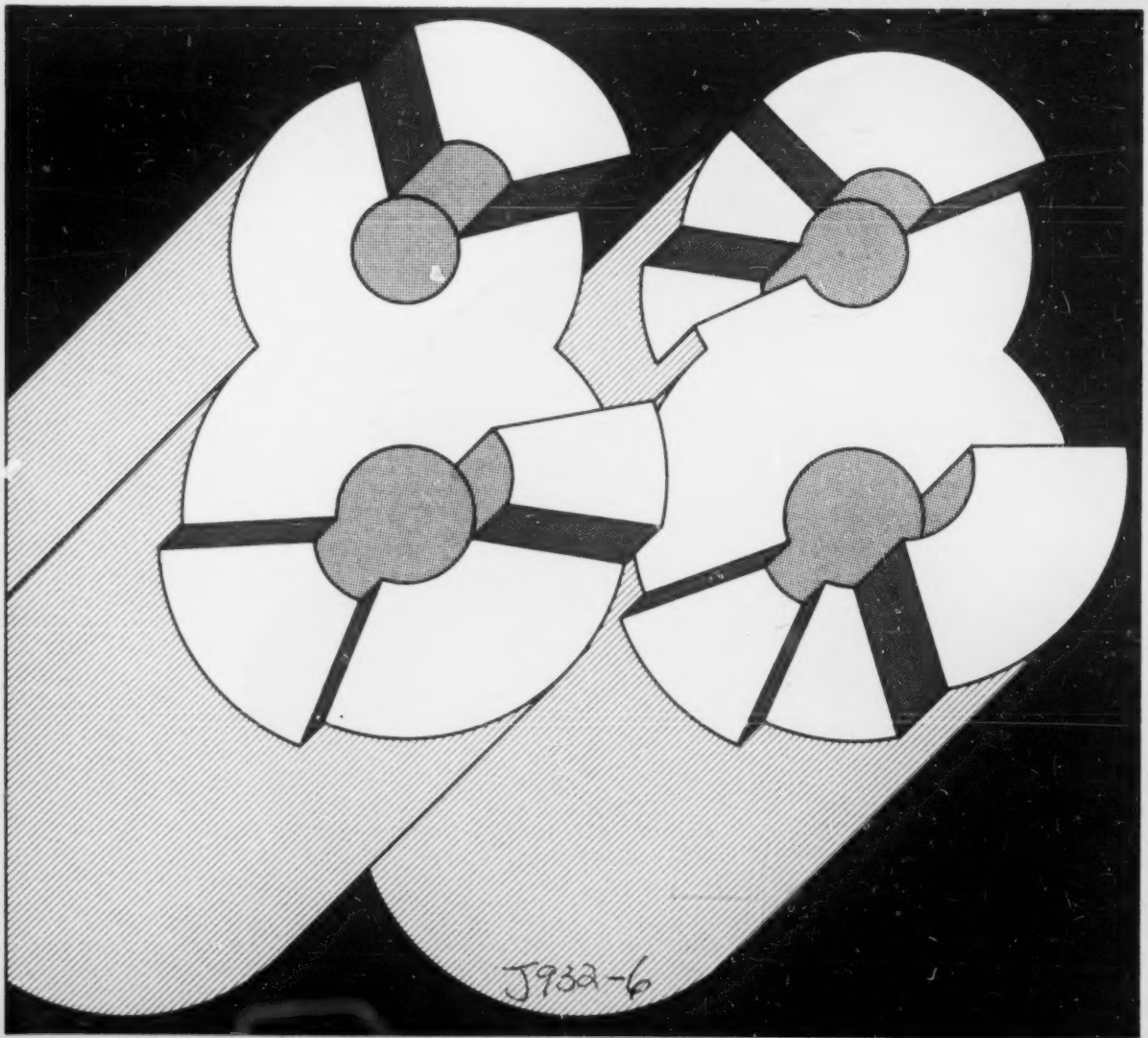

AN ANALYSIS OF THE PRESIDENT'S BUDGETARY PROPOSALS FOR FISCAL YEAR 1988

The Congress of the United States
Congressional Budget Office

NOTES

Unless otherwise indicated, all years referred to in this report are fiscal years.

Details in the text and tables of this report may not add to totals because of rounding.

The source of data concerning the President's budget is the Office of Management and Budget. The source of other data, unless otherwise noted, is the Congressional Budget Office.

The Balanced Budget and Emergency Deficit Control Act of 1985 is also referred to in this volume more briefly as the Balanced Budget Act.

PREFACE

This analysis of the President's budget for fiscal year 1988 was prepared at the request of the Senate Committee on Appropriations. The report discusses the President's policy proposals in terms of changes from the Congressional Budget Office (CBO) baseline budget projections for 1988-1992. It provides estimates of the budgetary impact of the Administration's proposals using CBO's economic assumptions and technical estimating methods.

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Rudolph G. Penner
Director

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CONTENTS

CHAPTER I Summary and Introduction 1

CBO Budget Estimates *2*
The Administration's Budget Program *5*

CHAPTER II A Comparison of Economic Assumptions 13

The Short-Run Outlook *13*
Medium-Term Projections *15*

CHAPTER III The Administration's Revenue Proposals 19

CBO Reestimates *19*
New Revenue Proposals *24*

CHAPTER IV The Administration's Defense Budget 33

Defense Funding Levels *33*
Estimates for Defense Outlays *35*
Major Defense Proposals *39*

CHAPTER V The Administration's Nondefense Budget

150 International Affairs *64*
250 General Science, Space, and Technology *70*
270 Energy *72*
300 Natural Resources and Environment *77*
350 Agriculture *82*
370 Commerce and Housing Credit *87*
400 Transportation *94*
450 Community and Regional Development *97*
500 Education, Training, Employment, and Social Services *102*

550 Health *110*
570 Medicare *115*
600 Income Security *122*
650 Social Security *131*
700 Veterans' Benefits and Services *133*
750 Administration of Justice *137*
800 General Government *140*
850 General Purpose Fiscal Assistance *142*
900 Net Interest *144*
920 Allowances *148*
950 Undistributed Offsetting Receipts *151*

CHAPTER VI The Administration's Credit Proposals 155

The Administration's Credit Budget *155*
Credit Reform *159*
Portfolio Loan Sales *165*

APPENDIXES

A Baseline Budget Projections 171

B Major Contributors 179

TABLES

I-1 The Budget Outlook Under the Administration Policies 2

I-2 CBO Reestimate of the Administration's Budget 3

I-3 Effects of CBO Economic Assumptions on Estimates of the Adminstration's Deficit 4

I-4 CBO Reestimates Resulting from Different Technical Assumption 5

I-5 The Administration's Budget Programs Estimated by CBO 6

I-6	CBO Estimates of the Administration's Budget Program	9
II-1	Comparison of Administration and CBO Short-Run Economic Forecast	14
II-2	Comparison of Administration and CBO Economic Assumptions, 1987-1992	16
III-1	Administration and CBO Estimates of Administration's Revenues by Major Source	20
III-2	CBO's Reestimates of Administration Budget Revenues	21
III-3	Sources of Reestimates	22
III-4	Differences Between CBO and Administration Economic Assumptions	23
III-5	Major Revenue Proposals in the Administration's 1988 Budget	25
III-6	CBO Estimates of the Revenue of the Administration's Proposed IRS Initiatives	26
III-7	CBO Estimates of the Administration's Social Insurance Proposals	27
III-8	CBO Estimates of the Administration's Black Lung Tax Proposals	29
III-9	CBO Estimates of the Administration's Excise Tax and Fee Proposals	30
IV-1	Major Spending Proposed in Administration's 1988 Budget for Function 050: National Defense	36
IV-2	Major Spending Changes Proposed in Administration's 1988 Budget for Function 050: National Defense	38
IV-3	Summary of Active Forces	41
IV-4	Real Percent Changes in Defense Budget Authority, By Appropriation Categories	43

IV-5	Requested Strength Levels for Military Personnel	44
IV-6	Real Changes in Operation and Maintenance	46
IV-7	Real Changes in Procurement Budget Authority	48
IV-8	Selected Program Changes in the 1988 Request for Aircraft Procurement	50
IV-9	Selected Program Changes in the 1988 Request for Other Missiles, Torpedoes, and Weapons Procurement	52
IV-10	Real Changes in Research, Development, Test and Evaluation	54
V-1	CBO Estimates of the Administration's Proposals in Nondefense Spending (In billions of dollars)	58
V-2	CBO Estimates of the Administration's Proposals in Nondefense Spending (In percent differences from the CBO baseline)	59
VI-1	The Administration's Credit Budget as Estimated by CBO	156
VI-2	Major Proposed Credit Program Changes, 1988-1992	157
VI-3	The Reallocation of Credit Costs Across Agency and New Revolving Fund Accounts Under the President's Credit Reform Proposal, Fiscal Year 1986	162
VI-4	Cash Outflow and Estimated Subsidy Cost	163
VI-5	Effect on the Budget of Reclassifying Credit Cash Flows as a Means of Financing	165
VI-6	Loan Assets Proposed for Sale, Administration Pilot Program, Face Value and Projected Receipts, Net of Lost Repayments, 1987-1992	166
A-1	Baseline Budget Projections	172
A-2	Major Differences Between Administration's and CBO's Budget Projections Under Current Policy	176

FIGURES

I-1	Federal Deficit Projections and Targets	1
I-2	The Composition of Federal Spending	10
IV-1	Sources of Growth in Defense Outlays, Fiscal Years 1987-1992	37

BOXES

I-1	Social Security in the Budget	11
IV-1	Inflation and Real Growth in the Defense Budget	34
IV-2	The Administration's Request for Supplemental 1987 Appropriations for Defense	40

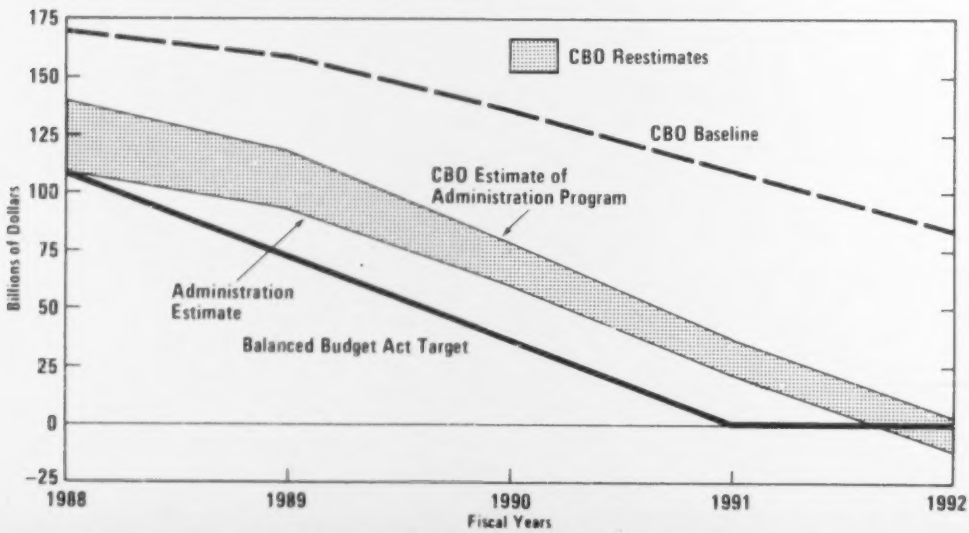
CHAPTER I

SUMMARY AND INTRODUCTION

CBO estimates that the federal deficit under Administration policies would be $134.4 billion in 1988, $117.1 billion in 1989, and $1.2 billion in 1992. These figures are noticeably higher than the Administration's own deficit estimates--$107.8 billion in 1988, $92.8 billion in 1989, and a surplus of $12.3 billion in 1992. CBO's estimate for 1988 represents a reduction of $36.1 billion below its baseline but is still $26.4 billion above the $108 billion target established in the Balanced Budget Act (see Figure I-1 and Table I-1).

CBO analyzes the Administration's budget in terms of changes from its baseline, which projects the course of the budget on the assumption that current taxing and spending policies continue unchanged. CBO reestimates, or reprices, the Administration's budget using CBO's economic and technical estimating assumptions and methods. The differences between the baseline projections and the CBO estimate of the budget measure the effects of the Administration's proposed policy changes. Appendix A further describes the baseline projections, which update those published last month in CBO's annual report, *The Economic and Budget Outlook: Fiscal Years 1988-1992*.

Figure I-1.
Federal Deficit Projections and Targets



SOURCE: Congressional Budget Office; Office of Management and Budget.
NOTE: Totals include Social Security, which is off-budget.

CBO BUDGET ESTIMATES

CBO's estimates of the deficit exceed the Administration's estimates by $3.0 billion in 1987, $26.6 billion in 1988, and declining amounts in later years. Table I-2 divides the CBO reestimates of the Administration's budget into those resulting from different economic assumptions and those resulting from technical factors. Most of the reestimates are economic.

Effects of Economic Assumptions

Although the differences between CBO and Administration economic assumptions are relatively small, they affect the budget estimates substantially. CBO's economic assumptions increase the estimated deficit by $4.2 billion in 1987, $15.0 billion in 1988, and $20.0 billion in 1992.

As detailed in Chapter II, CBO assumes consistently lower real economic growth, higher interest rates, and faster inflation than does the Administration. The first two factors tend to increase the estimated

TABLE I-1. THE BUDGET OUTLOOK UNDER THE ADMINISTRATION'S POLICIES (By fiscal year, in billions of dollars)

	1987	1988	1989	1990	1991	1992
Revenues						
Administration Estimate	842.4	916.6	976.2	1,048.3	1,123.2	1,191.2
CBO Estimate	834.2	905.4	969.1	1,058.8	1,146.9	1,230.6
Outlays						
Administration Estimate	1,015.6	1,024.3	1,069.0	1,107.7	1,144.4	1,178.9
CBO Estimate	1,010.4	1,039.8	1,086.2	1,136.7	1,182.6	1,231.9
Deficit (-) or Surplus						
Administration Estimate	-173.2	-107.8	-92.8	-59.5	-21.3	12.3
CBO Estimate	-176.2	-134.4	-117.1	-77.9	-35.7	-1.2
Balanced Budget Act Targets	-144.0	-108.0	-72.0	-36.0	0	0

SOURCES: Congressional Budget Office; Office of Management and Budget.
NOTE: Totals include Social Security, which is off-budget.

deficits, while the third tends to lower them (see Table I-3). Lower real economic growth holds down tax receipts, while increasing outlays for unemployment insurance and related programs. CBO's real growth assumption adds to the deficit in the President's budget by amounts growing from $7 billion in 1987 to $86 billion in 1992. Higher interest rates increase debt service costs by a negligible amount in 1987, $3 billion in 1988, and $18 billion in 1992.

Faster inflation increases most revenue sources (by increasing taxable incomes and consumption) but only raises some outlay categories (primarily indexed benefit programs). It therefore reduces the estimated deficits--by $3 billion in 1987, $8 billion in 1988, and $84 billion in 1992. CBO bases its estimates of defense and nondefense discretionary appropriations on the dollar value of the Administration's request; it does not increase the request to take account of CBO's higher assumed inflation rates. If CBO's inflation assumptions prove correct, these appropriations will buy fewer real goods and services than the Administration anticipates.

TABLE I-2. CBO REESTIMATE OF THE ADMINISTRATION'S BUDGET (By fiscal year, in billions of dollars)

	1987	1988	1989	1990	1991	1992
Deficit, President's Budget	173.2	107.8	92.8	59.5	21.3	-12.3a/
CBO Reestimates						
Economic						
Revenues	-3.9	-9.7	-9.8	-3.0	8.1	22.6
Outlays	0.3	5.3	11.2	19.0	30.1	42.7
Deficit	4.2	15.0	21.0	22.0	22.0	20.0
Technical						
Revenues	-4.3	-1.4	2.7	13.5	15.7	16.8
Outlays	-5.5	10.2	6.1	9.9	8.0	10.2
Deficit	-1.2	11.6	3.3	-3.6	-7.6	-6.5
Total Reestimates	3.0	26.6	24.4	18.4	14.4	13.5
Deficit, President's Budget as Estimated by CBO	176.2	134.4	117.1	77.9	35.7	1.2

SOURCES: Congressional Budget Office; Office of Management and Budget.
NOTE: Totals include Social Security, which is off-budget.

a. Surplus.

Effects of Technical Assumptions

Technical reestimates increase the estimated 1988 deficit by $11.6 billion--primarily by raising outlays. CBO's estimated spending for Medicare, which assumes a continuation of recent growth rates, exceeds the Administration figure by $5.0 billion (see Table I-4). CBO's estimates for Medicaid and income security programs are $3.3 billion higher than the Administration's. CBO also believes that the Administration's proposals for restructuring foreign military sales debt, recapitalizing the Federal Savings and Loan Insurance Corporation, and selling Amtrak assets--for which the budget includes a total of more than $3 billion in savings--would do little to reduce 1988 outlays. Technical reestimates of revenues add another $1.4 billion to the estimated 1988 deficit.

In the 1989-1992 period, the differences in the assumed growth of Medicare, Medicaid, and income security programs continue to raise the outlay figures, but technical reestimates also add to revenues by growing amounts. Principal among these differences are different assumptions about how taxpayers will respond to the Tax Reform Act of 1986. CBO assumes that taxpayers will be less successful than does the Administration in finding alternative ways to reduce their taxable incomes. In 1992, technical estimating differences add $16.8 billion to revenues, increase outlays by $10.2 billion, and reduce the estimated deficit by $6.5 billion. Chapters III, IV, and V describe CBO's reestimates of the Administration's budget in more detail.

TABLE I-3. EFFECTS OF CBO ECONOMIC ASSUMPTIONS ON ESTIMATES OF THE ADMINISTRATION'S DEFICIT
(By fiscal year, in billions of dollars)

	1987	1988	1989	1990	1991	1992
Lower Real Economic Growth	7	20	33	41	60	86
Higher Inflation	-3	-8	-16	-28	-51	-84
Higher Interest Rates	a/	3	5	8	13	18
Total Economic Reestimates	4	15	21	22	22	20

SOURCE: Congressional Budget Office.
NOTE: The figures include the changes in debt service costs caused by different borrowing.
a. Less than $0.5 billion.

THE ADMINISTRATION'S BUDGET PROGRAM

CBO's baseline projections provide a benchmark against which the Administration's budget program can be measured. Because the baseline and the CBO estimate of the budget employ the same economic and technical assumptions, differences between the two are solely the result of proposed policy changes. CBO estimates that the Administration's budget proposals would reduce the 1988 deficit to $134.4 billion--$36.1 billion below the baseline level of $170.6 billion. By 1992, the budget would be roughly in balance. Over the 1988-1992 period, the Administration's proposals would reduce the deficit by nearly $300 billion (see Table I-5).

The Administration is requesting an increase in real defense appropriations of about 3 percent in 1988 and 2 percent per year thereafter (on the basis of CBO's assumed rates of inflation). Proposed appropriations for procurement are lower than the 1987 amounts, while those for operation and

TABLE I-4. CBO REESTIMATES RESULTING FROM DIFFERENT TECHNICAL ASSUMPTIONS (By fiscal year, in billions of dollars)

	1987	1988	1989	1990	1991	1992
Revenues	-4.3	-1.4	2.7	13.5	15.7	16.8
Outlays						
Medicare	1.8	5.0	4.5	5.6	6.5	7.7
Medicaid	0.5	1.6	1.5	1.3	1.0	0.5
Income security	-0.8	1.7	2.9	2.8	4.3	5.8
FMS debt restructuring a/	0.2	1.1	-0.9	-0.9	-0.9	-0.8
Deposit insurance	-1.8	1.0	1.9	1.3	0.2	0.9
Sale of Amtrak assets	0	1.0	0	0	0	0
Net interest a/	-2.1	-1.4	-3.0	-3.1	-4.8	-2.3
Other a/	3.3	-0.1	0.9	-2.9	-1.7	1.5
Subtotal, Outlays	-5.5	10.2	6.1	9.9	8.0	10.2
Total Technical Reestimates	-1.2	11.6	3.3	-3.6	-7.6	-6.5

SOURCE: Congressional Budget Office.

a/. Intragovernmental transactions that are offset elsewhere in the budget have been removed.

TABLE I-5. THE ADMINISTRATION'S BUDGET PROGRAM AS ESTIMATED BY CBO (By fiscal year, in billion of dollars

Item	1988	1989	1990	1991	1992	Cumulative Five-Year Changes
CBO Baseline Deficit	170.6	164.4	136.8	109.5	84.0	
Defense Increases	7.8	9.2	14.0	17.5	23.1	71.6
Deficit Reductions						
Revenue increases	-5.0	-7.1	-7.7	-8.0	-8.2	-36.0
Outlay reductions						
Financial transactions	-6.6	-2.7	0.3	2.6	5.6	-0.7
Sale of physical assets	-2.8	-1.8	-1.7	-4.2	-2.1	-12.6
Spending delays	-6.5	-0.1	a/	a/	a/	-6.6
User fees and offsetting receipts	-2.7	-4.5	-5.3	-6.3	-7.4	-26.2
Nondefense discretionary programs	-10.7	-20.5	-28.9	-36.4	-43.9	-140.3
Entitlement programs	-8.5	-15.9	-22.3	-27.8	-34.3	-108.8
Debt service savings	-1.2	-4.0	-7.3	-11.3	-15.6	-39.4
Subtotal, reductions	-43.9	-56.5	-72.9	-91.4	-105.9	-370.5
Total Policy Changes	-36.1	-47.3	-58.9	-73.8	-82.8	-298.9
Deficit, President's Budget as Estimated by CBO	134.4	117.1	77.9	35.7	1.2	

SOURCES: Congressional Budget Office; Office of Management and Budget.

NOTE: Totals include Social Security, which is off-budget.

a. Less than $50 million.

maintenance and for research and development are higher. The higher appropriations sought by the Administration would increase defense outlays by $7.8 billion in 1988 and $71.6 billion over the 1988-1992 period compared with the CBO baseline, which assumes no real growth in defense spending.

To allow for this growth in defense while reducing the deficit, the Administration proposes cuts in nondefense spending and increases in revenues totaling $43.9 billion in 1988 and $370.5 billion over five years. Revenue increases account for $36.0 billion, or only 10 percent, of the five-year deficit reduction. Of this amount, $14.4 billion would result from adding over 10,000 positions to the Internal Revenue Service (IRS) examination and enforcement staff. (The revenue baseline already includes $17 billion in additional revenues from 1987 to 1992 resulting from the 5,500 new IRS positions added in the 1987 appropriation.) Extending Medicare coverage to all state and local employees would raise an additional $9.3 billion. Other revenue proposals include increasing railroad pension and unemployment insurance contributions, increasing the the coal tax that finances the Black Lung program, and eliminating the exemption of state and local governments and most bus companies from highway excise taxes.

The Administration is proposing a number of financial transactions that would reduce recorded outlays in the short run, especially in 1988, though generally at the cost of increased spending later on. These financial transactions account for $6.6 billion, or 15 percent, of the $43.9 billion in deficit reduction in 1988, but add $5.6 billion to the 1992 deficit (not counting debt service savings). Sales of existing loan assets of the Export-Import Bank, Farmers Home Administration, and other agencies produce $5.3 billion in outlay reductions in 1988. In addition, as part of its credit reform proposals (discussed in Chapter VI), the Administration is proposing to sell a number of new loans soon after they are made.

The proposed sale of physical assets--primarily the Naval Petroleum Reserves and the power marketing administrations--reduces outlays by $2.8 billion in 1988 and $12.6 billion over five years. The loss of receipts from the sale of oil and electricity, however, would add to the deficit after 1992.

Although these asset sales provide a temporary reduction in the deficit under current accounting conventions, they squeeze credit markets in almost the same fashion as borrowing by the government. The amount paid for the asset is no more available for private investment than is a like amount loaned to the Treasury.

Proposed delays in spending for Medicare and farm price supports cause a one-time reduction in outlays of $6.5 billion in 1988 but make no lasting

contribution to deficit reduction. Delaying the reimbursement of hosptals and doctors for Medicare services reduces 1988 outlays by $2.0 billion. Not making advance deficiency payments to farmers, though done in 1987 and three out of the past four years, lowers 1988 outlays by $4.5 billion compared with the CBO baseline.

The Administration is proposing to increase a number of charges and fees that are recorded in the budget as offsets to outlays rather than as tax revenues. Increased premiums for Supplementary Medical Insurance (Part B of Medicare) account for $16.8 billion of the $26.2 billion to be raised through such user fees over the next five years. The Administration is also proposing to charge more for Federal Housing Administration and Veterans Administration home mortgage insurance, for pension benefit guarantees, and for use of the national parks and forests, and to impose fees for Coast Guard services and meat and poultry inspection.

The foregoing proposals to raise revenues, sell physical and financial assets, delay payments, and increase charges for services constitute a little over 20 percent of the Administration's five-year deficit reduction total. Debt service savings contribute another 10 percent of the savings. The bulk of the deficit reduction, however, is achieved through cutbacks in nondefense discretionary and entitlement programs.

Proposed cuts in nondefense discretionary spending total $140.3 billion over the 1988-1992 period. Among the largest proposed reductions are Farmers Home Administration direct loans, excluding asset sales ($16.3 billion), transportation programs ($15.4 billion), assistance for college students ($13.9 billion), civilian agency pay raises ($14.0 billion), energy supply and conservation ($13.9 billion), natural resources and environment ($12.1 billion), elementary and secondary education ($11.1 billion), Public Health Service programs ($10.7 billion), and housing assistance ($8.5 billion). Similar reductions were proposed in last year's budget, but not enacted. Increases are proposed for international affairs, science and space, and the Internal Revenue Service.

Proposed reductions in Medicare and Medicaid would reduce outlays by $56.7 billion--half of the five-year savings in entitlement programs. Reductions in Commodity Credit Corporation (CCC) direct loans and income support payments to farmers would save another $20.7 billion. Federal employee retirement and health benefits would be cut by $10.5 billion, child nutrition and food stamps by $7.1 billion, and guaranteed student loans by $6.6 billion. With the exception of CCC, most of these proposals were also advanced but rejected last year.

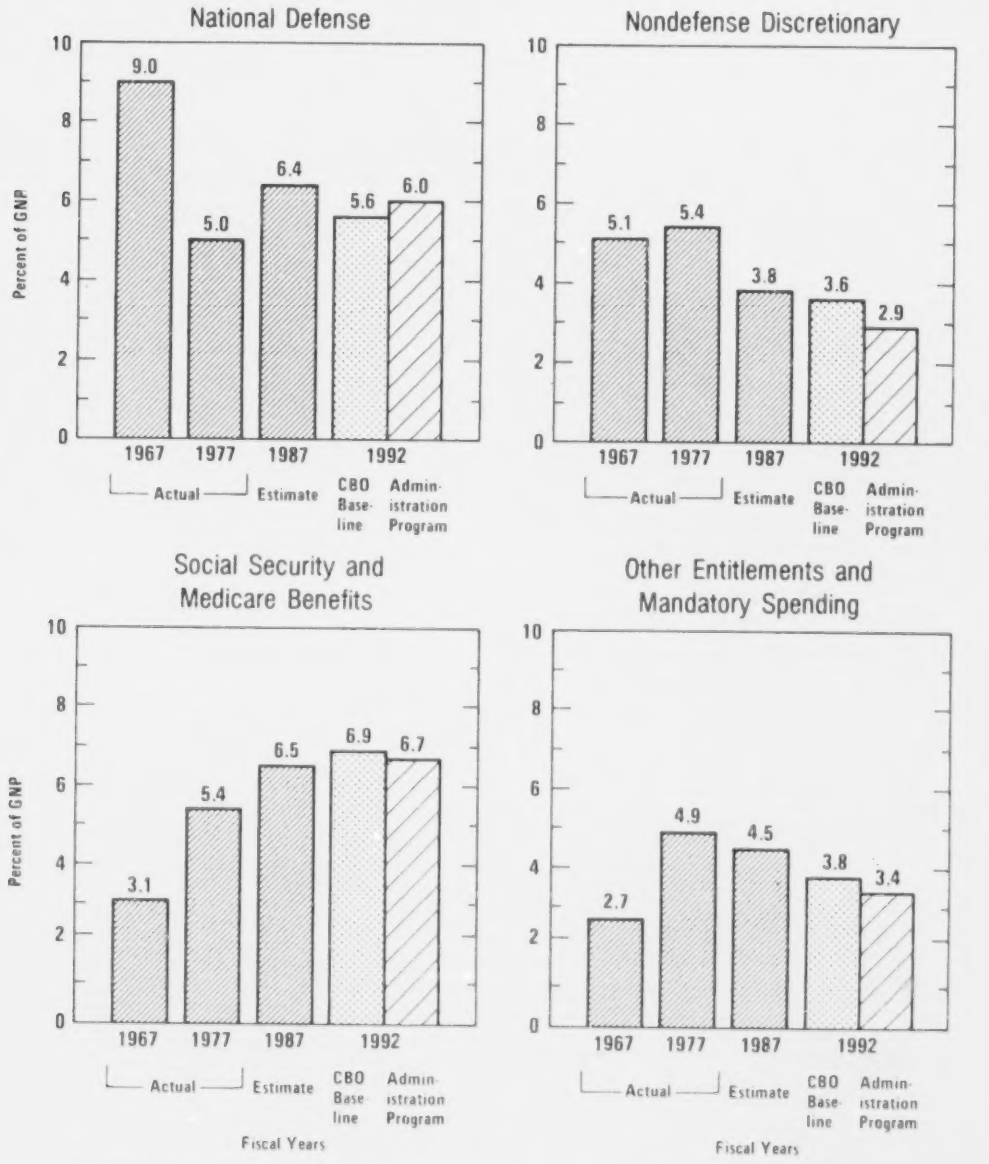
The proposed increases in defense and the cuts in nondefense programs would change the composition of federal spending, as set forth in Table I-6 and Figure I-2. In this table, the financial transactions, spending delays, and

TABLE I-6. CBO ESTIMATES OF THE ADMINISTRATION'S BUDGET PROGRAM
(By fiscal year)

	1987	1988	1989	1990	1991	1992
			In Billions of Dollars			
Revenues						
Individual income	361.3	381.4	413.4	459.2	503.0	546.8
Corporate income	100.6	119.3	127.1	139.1	152.0	164.2
Social insurance	300.8	331.8	356.7	386.8	416.2	441.5
Other	71.5	72.9	71.9	73.7	75.8	78.1
Total	834.2	905.4	969.1	1,058.8	1,146.9	1,230.6
Outlays						
National defense	281.5	298.3	312.6	331.1	349.8	369.9
Entitlements	480.7	493.8	524.5	552.8	586.7	622.7
Nondefense discretionary	167.4	172.0	173.3	178.9	179.4	180.0
Net interest	133.7	139.0	143.1	145.2	144.8	139.9
Offsetting receipts	-52.9	-63.3	-67.3	-71.3	-78.0	-80.7
Total	1,010.4	1,039.8	1,086.2	1,136.7	1,182.6	1,231.9
Deficit	176.2	134.4	117.1	77.9	35.7	1.2
Debt Held by the Public	1,913.2	2,045.5	2,160.4	2,236.4	2,269.0	2,269.3
			As a Percent of GNP			
Revenues						
Individual income	8.2	8.1	8.2	8.5	8.7	8.8
Corporate income	2.3	2.5	2.5	2.6	2.6	2.7
Social insurance	6.8	7.1	7.1	7.2	7.2	7.1
Other	1.6	1.6	1.4	1.4	1.3	1.3
Total	19.0	19.3	19.3	19.6	19.8	19.9
Outlays						
National defense	6.4	6.3	6.2	6.1	6.0	6.0
Entitlements	10.9	10.5	10.4	10.2	10.1	10.1
Nondefense discretionary	3.8	3.7	3.4	3.3	3.1	2.9
Net interest	3.0	3.0	2.8	2.7	2.5	2.3
Offsetting receipts	-1.2	-1.3	-1.3	-1.3	-1.3	-1.3
Total	23.0	22.1	21.6	21.0	20.4	19.9
Deficit	4.0	2.9	2.3	1.4	0.6	a/
Debt Held by the Public	43.5	43.5	42.9	41.4	39.2	36.7
Memorandum: GNP	4,399	4,698	5,033	5,406	5,792	6,186

SOURCE: Congressional Budget Office.
NOTE: Totals include Social Security, which is off-budget.
a. Less than 0.05 percent.

Figure I-2.
The Composition of Federal Spending



SOURCE: Congressional Budget Office

BOX I-1
SOCIAL SECURITY IN THE BUDGET

CBO's analysis of the 1988 budget focuses on its implications for total revenues, outlays, and deficits. The federal budget, however, includes both on- and off-budget activities. The Balanced Budget Act of 1985 moved the Old-Age, Survivors, and Disability Insurance (OASDI) trust funds off-budget but nevertheless included them in setting deficit targets. The total budget deficit also determines the federal government's borrowing needs.

CBO's estimates of on- and off-budget revenues, outlays, and the deficit under the Administration's budgetary proposals are shown below. CBO projects that, under the Administration's policies, the total federal budget would be virtually in balance in 1992. But this balance reflects a large surplus in Social Security and a large deficit for other federal government activities.

Almost all of the Administration's proposed policy changes affect on-budget revenues and outlays. For Social Security the President proposes only small revenue increases (from covering more earnings) and small outlay reductions (from limiting administrative costs). These proposals are discussed in Chapters III and V.

	1987	1988	1989	1990	1991	1992
			In Billions of Dollars			
Revenues						
On-budget	620.5	664.5	707.0	771.2	835.3	898.0
Off-budget (OASDI)	213.7	240.9	262.2	287.5	311.6	332.6
Total	834.2	905.4	969.1	1,058.8	1,146.9	1,230.6
Outlays						
On-budget	815.6	835.3	870.8	908.6	941.1	976.4
Off-budget (OASDI)	194.8	204.5	215.4	228.1	241.6	255.4
Total	1,010.4	1,039.8	1,086.2	1,136.7	1,182.6	1,231.9
Deficit (-) or Surplus						
On-budget	-195.1	-170.9	-163.9	-137.4	-105.7	-78.4
Off-budget (OASDI)	18.9	36.5	46.7	59.5	70.0	77.2
Total	-176.2	-134.4	-117.1	-77.9	-35.7	-1.2

asset sales have been allocated to the categories of spending to which they apply. For example, most of the loan asset sales are treated as reducing nondefense discretionary spending, while delays in Medicare and farm price support payments hold down entitlement outlays.

With 2 percent to 3 percent real growth in defense appropriations, defense outlays would grow slightly less rapidly than GNP. National defense spending would absorb 6.4 percent of GNP in 1987 and 6.0 percent in 1992. In the CBO baseline, which assumes no real defense growth, the 1992 defense share is only 5.6 percent of GNP.

The budget proposals would accelerate the projected decline in nondefense spending. Nondefense discretionary spending currently represents 3.8 percent of GNP, substantially below the level of 10 or 20 years ago. In the baseline, it declines to 3.6 percent of GNP by 1992, and under the Administration program, it falls to 2.9 percent. Social Security and Medicare benefits grow from 6.5 percent of GNP in 1987 to 6.7 percent in 1992 in CBO's estimate of the budget. The Administration is proposing various reductions in Medicare but no cuts in Social Security benefits (see the box on the preceding page). Under the Administration's policies, other entitlements and mandatory spending decline from 4.5 percent of GNP in 1987 to 3.4 percent in 1992.

CHAPTER II

A COMPARISON OF ECONOMIC ASSUMPTIONS

Economic assumptions play an important role in budget estimates. Differences in assumptions of GNP growth, unemployment, and inflation have a substantial impact on projected tax receipts and spending in the various entitlement and indexed programs. Interest rate assumptions have also become increasingly crucial as debt servicing costs make up a larger part of total expenditures.

In general, CBO's and the Administration's economic projections are similar. Nevertheless, there are some forecast differences that are within the bounds of historical forecast error but of sufficient magnitude to be of consequence for budget estimates. This chapter reviews the major economic assumptions of CBO and the Administration. CBO's assumptions are used in later chapters in reestimating the Administration's 1988 budget proposals.

THE SHORT-RUN OUTLOOK

After two years of economic growth around 2.5 percent, CBO forecasts a moderate pickup in economic activity for 1987 and 1988 (see Table II-1). Real GNP is expected to grow at just under 3 percent, and unemployment is expected to fall to around 6.5 percent by the end of this period. The Consumer Price Index (CPI) is expected to increase at almost a 4.5 percent annual pace over the next two years, up from only around a 1 percent rate last year. Both long-term and short-term interest rates are projected to average one-half a percentage point less than in 198[illegible].

The Administration's forecast for 1987 is quite similar to that of CBO, although the Administration has slightly higher real GNP and somewhat lower inflation and interest rates. The differences for 1988 are more pronounced, however, with the Administration's forecast for real economic growth almost one percentage point higher and its inflation forecast almost one percentage point lower than that projected by CBO. The Administration's short-term interest rate forecast is very close to that of CBO, but its long-term interest rate forecast is about one-half a percentage point lower than that of CBO in both 1987 and 1988.

TABLE II-1. COMPARISON OF ADMINISTRATION AND CBO SHORT-RUN ECONOMIC FORECASTS (By calendar year)

Economic Variable	Actual 1986	Forecast 1987	Forecast 1988
Fourth Quarter to Fourth Quarter (Percent change)			
Real GNP			
Administration	2.2	3.2	3.7
CBO	2.2	3.0	2.9
Nominal GNP			
Administration	4.4	6.9	7.3
CBO	4.4	6.5	7.1
Consumer Price Index a/			
Administration	0.9	3.8	3.6
CBO	0.9	4.4	4.4
Calendar-Year Average (Percent)			
Three-Month Treasury Bill Rate			
Administration	6.0	5.4	5.6
CBO	6.0	5.6	5.7
Ten-Year Government Bond Rate			
Administration	7.7	6.7	6.6
CBO	7.7	7.2	7.2
Civilian Unemployment Rate			
Administration b/	6.9	6.7	6.3
CBO	7.0	6.6	6.5

SOURCE: Congressional Budget Office; Office of Management and Budget.

a. Urban wage earners and clerical workers.

b. The Administration's projection is for the total labor force including armed forces residing in the United States, while CBO's is for the civilian labor force excluding armed forces. In recent years, the former has tended to be 0.1 to 0.2 percentage points below the rate for the civilian labor force alone.

Both CBO's and the Administration's forecasts contain a considerable measure of uncertainty. Each was made before the most recent rise in oil prices and the decline in the value of the dollar. These recent movements may prove to be transitory. If they persist, however, they could affect these forecasts. Both higher oil prices and a weaker dollar tend to raise inflation. While higher oil prices tend to slow real economic growth, a weaker dollar should, over time, lead to faster growth in real GNP.

MEDIUM-TERM PROJECTIONS

Neither CBO nor the Administration attempts to forecast the economy beyond the end of 1988. In making their projections for 1989 through 1992 (shown in Table II-2), both organizations rely on simple rules of thumb based on historical experience.

CBO bases its medium-term projection of GNP on projections of gross domestic product (GDP), which differs from GNP by excluding the net income earned by U.S. residents on overseas assets. During the postwar period, real GDP growth has averaged about 3.2 percent, and CBO assumes that it will continue at that rate until it reaches CBO's estimate of potential GDP in 1990. After that, CBO assumes that it will continue to grow at 2.6 percent, the estimated growth rate of potential GDP. Because U.S. net international indebtedness is likely to rise for some years to come, the flow of net income from overseas assets is expected to decline. Hence, the growth of GNP should trail behind the growth in GDP over the medium term, falling from 3.0 percent in 1989 to 2.5 percent in 1992. CBO projects that, accompanying this steady growth in GNP, there will be a gradual decline in the civilian unemployment rate to 6 percent in 1991 and 1992.

CBO projects that inflation, as measured by the Consumer Price Index (CPI), will remain flat at 4.3 percent over the 1989-1992 period, with a similar outcome expected for inflation as measured by the GNP Implicit Price Deflator. Despite the assumed rise in inflation from current levels, CBO projects that both nominal and real interest rates will fall gradually over the medium term, with nominal interest rates reaching 5.2 percent for three-month Treasury bills and 5.6 percent for 10-year government bonds by 1992. This Treasury bill rate, together with CBO's projected inflation rate, approximates the historical average for the real short-term interest rate.

The Administration's medium-term projections are based on long-term trends and how it views the implications of its policy proposals. Its projections are similar to CBO's for nominal GNP (the difference between the pro-

TABLE II-2. COMPARISON OF ADMINISTRATION AND CBO ECONOMIC ASSUMPTIONS, 1987-1992 (By calendar year)

Economic Variable	Actual 1986	1987	1988	1989	1990	1991	1992
Nominal GNP (billions of dollars)							
Administration	4,208	4,493	4,816	5,165	5,524	5,879	6,214
CBO	4,208	4,469	4,779	5,124	5,503	5,888	6,288
Real GNP (percent change)							
Administration	2.5	3.1	3.5	3.6	3.6	3.5	3.4
CBO	2.5	2.8	3.0	3.0	3.1	2.7	2.5
Consumer Price Index a/ (percent change)							
Administration	1.6	3.0	3.6	3.6	3.2	2.8	2.2
CBO	1.6	3.5	4.3	4.3	4.3	4.3	4.3
GNP Deflator (percent change)							
Administration	2.7	3.3	3.5	3.5	3.2	2.8	2.3
CBO	2.7	3.2	3.8	4.1	4.2	4.2	4.2
Three-Month Treasury Bill Rate (percent)							
Administration	6.0	5.4	5.0	5.3	4.7	4.2	3.6
CBO	6.0	5.6	5.7	5.6	5.5	5.3	5.2
Ten-Year Government Bond Rate (percent)							
Adminstration	7.7	6.7	6.6	6.1	5.5	5.0	4.5
CBO	7.7	7.2	7.2	6.6	6.2	5.9	5.6
Civilian Unemployment Rate (percent)							
Administration b/	6.9	6.7	6.3	6.0	5.8	5.6	5.5
CBO	7.0	6.6	6.5	6.3	6.1	6.0	6.0

SOURCE: Congressional Budget Office; Office of Management and Budget.

NOTE: Percent change is for calendar-year averages.

a. Urban wage and clerical workers.

b. The Administration's projection is for the total labor force. See footnote b of Table II-1.

jections is less than 1 percent except in the final year), but the Administration assumes a declining rate of inflation, higher real GNP growth, and lower unemployment. The GNP projection assumes that the number of hours worked in the economy will grow over the medium term at the same rate as it did from 1981 to 1986 and that the output per hour worked will grow over the period at its rate for the 1948-1981 period. 1/Under these assumptions, the Administration projects that real GNP will grow at about a rate of 3.5 percent for the years 1989 through 1991, falling to 3.4 percent in 1992. CBO assumes about the same rate of growth for hours worked and slightly slower growth in productivity.

The Administration's assumed rate of inflation is lower than CBO's over the medium term. Using the CPI, the Administration projects that inflation will fall steadily from 3.6 percent in 1989 to 2.2 percent in 1992, with a similarly declining rate when inflation is measured using the GNP deflator. At these lower rates of inflation, the Administration's projected real 1992 GNP is 3.8 percent higher than CBO's projection. Though the Administration's projected GNP growth rate exceeds CBO's baseline path, it is well below CBO's alternative "high-growth path" economic projection. 2/

With higher growth and lower inflation than assumed by CBO, the Administration's projections also contain a faster drop in the unemployment rate, reaching 5.5 percent by 1992 as compared with CBO's assumed 6.0 percent. In line with the Administration's lower inflation projections, nominal interest rates are assumed to fall steadily faster than projected by CBO. By 1992, yields on three-month Treasury Bills are projected to be 3.6 percent by the Administration, compared with 5.2 percent according to CBO. Similarly, interest rates on 10-year government bonds are projected to be 4.5 percent and 5.6 percent by the Administration and CBO, respectively. Real interest rates on both short- and long-term securities, however, are lower under the CBO projections over the entire 1989-1992 projection period.

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1. See *Economic Report of the President* (February 1987), Table 1-6, p. 62.

2. See Congressional Budget Office, *The Economic and Budget Outlook: Fiscal Years 1988-1992* (January 1987), pp.8-9.

CHAPTER III

THE ADMINISTRATION'S REVENUE PROPOSALS

CBO's estimate of total revenues under the President's budget program falls $11 billion short of the Administration's estimate in 1988 and $7 billion short in 1989. The CBO estimate exceeds the Administration's by increasing amounts in 1990 to 1992, reaching $39 billion above the Administration's estimate in 1992. For the most part, these differences reflect different assumptions about the economy and about the revenue effects of tax reform.

The President's revenue proposals are very minor elements in the total revenue picture over the 1988-1992 period. By 1992, they would add only 0.7 percent to revenues. CBO's estimate of the revenue increase generated by these proposals is $5 billion in fiscal year 1988, $7 billion in 1989, and $8 billion each year from 1990 through 1992--about $1 billion below the Administration's estimate in each year.

The President's budget proposals discussed in this chapter involve taxes and fees that are classified as revenues in the unified budget. The President's budget report also classifies credit reform, asset sale, and other user fee proposals as revenue changes. 1/ In keeping with unified budget accounting conventions, these other changes, which affect the outlay side of the budget, are considered elsewhere in this analysis (see Chapter V).

CBO REESTIMATES

Using its own economic assumptions and estimation procedures, CBO projects that revenues under Administration policy, including those off-budget, will total $905 billion in 1988, $1,059 billion in 1990, and $1,231 billion in 1992 (see Table III-1). 2/ Revenues grow more rapidly than GNP

1. *Budget of the United States Government for Fiscal Year 1988* (January 1987), p. 2-39.

2. Both CBO and the Administration extend Airport and Airway, Highway, and Superfund taxes at current rates through 1992. These taxes are scheduled to expire before 1992. Off-budget revenues consist of federal Old-Age and Survivors and Disability Insurance Trust Fund (OASDI) revenues.

TABLE III-1. ADMINISTRATION AND CBO ESTIMATES OF ADMINISTRATION'S REVENUES, BY MAJOR SOURCE (By fiscal year, in billions of dollars)

Revenue Source	1987	1988	1989	1990	1991	1992
Administration Estimates						
Individual Income Taxes	364.0	392.8	417.3	450.8	489.0	523.7
Corporate Income Taxes	104.8	117.2	128.6	139.8	149.2	160.5
Social Insurance Taxes and Contributions	301.5	333.2	357.2	384.0	409.9	431.2
On-budget	87.4	91.1	93.8	97.3	102.2	106.0
Off-budget a/	214.0	242.1	263.4	286.6	307.7	325.3
Excise Taxes	32.6	33.4	32.9	33.7	34.3	35.2
Other	39.6	40.0	40.2	40.0	40.8	40.6
Total Revenues	842.4	916.6	976.2	1,048.3	1,123.2	1,191.2
Percent of GNP	19.1	19.4	19.2	19.3	19.4	19.4
CBO Estimates						
Individual Income Taxes	361.3	381.4	413.4	459.2	503.0	546.8
Corporate Income Taxes	100.6	119.3	127.1	139.1	152.0	164.2
Social Insurance Taxes and Contributions	300.8	331.8	356.7	386.8	416.2	441.5
On-budget	87.1	90.8	94.6	99.3	104.6	108.9
Off-budget a/	213.7	240.9	262.2	287.5	311.6	332.6
Excise Taxes	32.7	33.2	32.6	33.2	33.8	34.4
Other	38.8	39.8	39.3	40.4	42.0	43.7
Total Revenues	834.2	905.4	969.1	1,058.8	1,146.9	1,230.6
Percent of GNP	19.0	19.3	19.3	19.6	19.8	19.9

SOURCES: *Budget of the United States Government for Fiscal Year 1988* and Congressional Budget Office.

a. Off-budget revenues consist of federal Old-Age and Survivors and Disability Insurance Trust Fund (OASDI) revenues.

over the 1988-1992 period, rising from 19.5 percent of GNP in 1988 to 19.9 percent in 1992.

Almost all of the difference between the CBO and Administration revenue estimates resides in their estimates of baseline revenues (see Table III-2). The major source of reestimates shifts over time. Economic assumptions are the major factor in CBO's reestimate in the 1987-1989 period. Technical assumptions, primarily about tax reform, are the major factor thereafter (see Table III-3).

Differences in Economic Assumptions

CBO projects lower real growth and higher inflation than does the Administration. In the period 1988 through 1990, CBO's nominal GNP is lower than the Administration's because CBO's lower real growth assumption dominates the difference in assumed inflation rates. In 1991 and 1992, CBO's nominal GNP rises above the Administration's because CBO's higher inflation rates become relatively more important (see Table III-4). CBO's nominal GNP path rises from 1 percent below the Administration's GNP in 1988 to 1 percent above in 1992. (For a discussion of CBO and Administration economic projections, see Chapter II.)

TABLE III-2. CBO'S REESTIMATES OF ADMINISTRATION BUDGET REVENUES (By fiscal year, in billions of dollars)

	1987	1988	1989	1990	1991	1992
Revenues as Estimated by the Administration a/	842	917	976	1,048	1,123	1,191
Reestimates of baseline revenues	-8	-10	-6	11	25	40
Reestimates of proposals	b/	-1	-1	-1	-1	-1
Total CBO Reestimates	-8	-11	-7	10	24	39
Revenues as Reestimated by CBO a/	834	905	969	1,059	1,147	1,231

a. Revenues include payroll tax receipts of the federal Old-Age and Survivors and Disability Insurance Trust Funds (OASDI), which are off-budget.

b. Less than $500 million.

Federal tax bases generally follow nominal GNP growth, and projected revenues vary accordingly. The principal economic assumptions with direct bearing on projected revenues are personal and corporate income levels and the volume of transactions in goods and services subject to federal excise taxes, which can be approximated by GNP. Both CBO's personal income tax base and payroll tax base (wages and salaries) are below Administration estimates over the 1987-1989 period and above them thereafter (see Table III-4). CBO's corporate income tax base (book profits) is below the Administration's estimate over the 1987-1990 period and above it in 1991 and 1992.

Because the individual income tax will be indexed again beginning in 1989 (after a two-year pause as tax reform is phased in), the assumption about the inflation-output mix in income growth also plays an important role in determining revenues. CBO projects higher inflation than does the Administration. CBO's progressively higher assumptions about merchandise imports produce higher customs duty receipts over the 1988-1992 period.

Differences in Technical Assumptions

CBO estimates of Administration budget revenues differ from Administration estimates for reasons other than economic assumptions. Chief among these reasons are assumptions about changes in the timing of tax payments, the organizational form in which income is earned (corporate versus noncorporate), and the response of taxpayers to changes in tax law.

TABLE III-3. SOURCES OF REESTIMATES (By fiscal year, in billions of dollars)

	1987	1988	1989	1990	1991	1992
Economic Assumptions	-4	-10	-10	-3	8	23
Technical Assumptions	-4	-1	3	13	16	17
Total Reestimates	-8	-11	-7	10	24	39

SOURCE: Congressional Budget Office.

Technical assumptions have a minor effect on estimated revenues in 1988. They account for only $1 billion of CBO's $11 billion lower estimate of total revenues in this year (see Table III-3). Beginning in 1989, however, technical assumptions, especially assumptions about tax reform, exert a growing upward influence on CBO revenues. In 1991 and 1992, technical assumptions, taken together, put CBO's estimates above the Administration's by $16 billion and $17 billion, respectively, or about 1 percent of revenues.

Differences in estimates of four provisions of the Tax Reform Act of 1986 sum to roughly three-quarters of the total difference in technical assumptions in the 1990-1992 period. These provisions address individual income taxation of capital gains and Individual Retirement Account contributions, consumer interest deductibility, and the alternative minimum tax. For these estimates, CBO has generally followed assumptions adopted by the Joint Committee on Taxation (JCT), while the Administration has used those of the Treasury Department. CBO and the JCT assume that individual taxpayers will be less successful in finding ways to reduce their taxable incomes and, thereby, their taxes, in response to these changes. These discrepancies are partially offset in other provisions of tax reform. For example, the Treasury projects greater corporate income tax gain by 1990 from several business provisions--in particular, the passive loss and accounting provisions.

TABLE III-4. DIFFERENCES BETWEEN CBO AND ADMINISTRATION ECONOMIC ASSUMPTIONS (By calendar year, in billions of dollars)

Economic Variable	1987	1988	1989	1990	1991	1992
GNP	-24	-37	-41	-21	10	74
Personal Income Tax Base a/	-13	-22	-18	5	35	71
Wages and Salaries b/	-9	-19	-16	7	34	66
Corporate Book Profits b/	-9	-27	-16	-11	6	18

NOTE: Differences are measured by subtracting the Administration assumptions from the CBO assumptions.

a. National Income and Product Account wage and salary disbursements plus nonwage personal income adjusted by excluding certain nontaxable components and including capital gains. Calculated by CBO.

b. National Income and Product Account measures.

68-375 O - 87 - 2

NEW REVENUE PROPOSALS

CBO estimates that the President's new revenue proposals would increase revenues by $36 billion over the 1987-1992 period (see Table III-5). The Administration estimates a revenue increase of $41 billion. The President proposes, for the third year, to increase Internal Revenue Service (IRS) staffing to improve enforcement and accelerate collection of delinquent liabilities. These initiatives would increase revenues by about $14 billion and require the appropriation of an additional $2 billion to the IRS over the 1988-1992 period. The remaining $22 billion in proposed revenue increases would require new tax legislation--three-quarters in payroll tax increases and one-quarter in new or increased excise taxes and fees. (Housing and Urban Development fees, proposed again this year, can be instituted administratively.)

The President's program also includes repeal of the windfall profit tax on crude oil. Because no windfall profit tax liability is projected to be incurred over the 1988-1992 period--oil prices projected by both CBO and the Administration are too low--repeal would have no effect on revenues over the period.

Internal Revenue Service Initiatives

The President proposes to increase IRS examination and enforcement staffs by more than 10,000 positions by 1989, at a cost of about $2 billion over the 1988-1992 period. The initiatives would increase total IRS staff by about 10 percent. The new positions would be in addition to the roughly 5,500 new examination and enforcement positions funded in October 1986 in the continuing resolution for fiscal year 1987. CBO estimates that the proposed new agents and other employees combined with the proposed automation of the examination system will increase tax collections by $1.8 billion in 1988 and $14.4 billion over the 1988-1992 period (see Table III-6). This increase in tax collections is in addition to the $17 billion increase over the 1987-1992 period ($3.1 billion in 1988) that is already included in CBO baseline revenues, and is attributable to retention of the new agents hired under the continuing resolution.

The revenue gain from an IRS staff increase depends on the size of the staff increase and on revenue yield factors specific to the types of positions or the tasks at hand. CBO has reduced the Administration's estimate of proposed revenue gain by $0.5 billion in 1988 to reflect the lower productivity expected of IRS employees during the first year of employment. Moreover, because CBO has substituted a lower yield-to-cost ratio for

TABLE III-5. MAJOR REVENUE PROPOSALS IN THE ADMINISTRATION'S 1988 BUDGET
(By fiscal year, in billions of dollars)

	1987	1988	1989	1990	1991	1992	Cumulative 1987-1992 Changes
CBO Baseline Revenues a/	834.1	900.5	962.0	1,051.0	1,138.9	1,222.5	
Proposed Changes b/							
IRS initiatives	n.a.	1.8	2.9	3.1	3.2	3.3	14.4
Requiring Medicare contributions of all state and local employees	n.a.	1.3	1.9	1.9	2.0	2.1	9.3
Other social insurance proposals	n.a.	0.7	1.1	1.1	1.2	1.2	5.3
Black Lung proposals	n.a.	0.3	0.5	0.4	0.4	0.4	2.0
Excise taxes and fees	0.1	0.8	0.7	1.1	1.2	1.2	5.1
Total	0.1	5.0	7.1	7.7	8.0	8.2	36.1
President's Budget Revenues as Reestimated by CBO	834.2	905.4	969.1	1,058.8	1,146.9	1,230.6	

SOURCE: Congressional Budget Office.

NOTES: The President's credit reform, asset sale, and other user fee proposals referred to as revenue changes in the *Budget of the United States Government for Fiscal Year 1988* (January 5, 1987), p. 2-39 are not included here. They are accounted for on the outlay side of the unified budget.

n.a. = not applicable.

a. Revenues under current law, including extensions of Airport and Airway, Highway Fund, and Superfund taxes at rates in effect upon expiration of these taxes in December 1987, September 1988, and December 1991, respectively. Baseline revenues also include off-budget OASDI revenues.

b. Net of reduced income taxes and exclusive of costs of proposed changes.

TABLE III-6. CBO ESTIMATES OF THE REVENUE OF THE ADMINISTRATION'S PROPOSED IRS INITIATIVES a/
(By fiscal year, in billions of dollars)

Proposal	1988	1989	1990	1991	1992	Cumulative Five-year Changes
Staff Increases						
Examinations staff	0.4	1.2	1.3	1.4	1.5	5.9
Collections staff	0.7	1.0	1.0	1.0	1.0	4.7
Tax shelter staff	0.4	0.4	0.4	0.4	0.3	1.9
Document matching staff	0.2	0.3	0.3	0.3	0.3	1.3
Service center staff	0.1	0.1	0.1	0.1	0.1	0.4
System Automation	0.1	0.1	0.1	0.1	0.1	0.3
Total	1.8	2.9	3.1	3.2	3.3	14.4

SOURCE: Congressional Budget Office.

a. Gross revenues. The cost of these initiatives, estimated at approximately $2.1 billion over the 1988-1992 period, is not included in these revenue estimates.

the proposed new positions on the collections (accounts receivable) staff, it has reduced the Administration's revenue gain estimate for the 1988-1992 period by another $0.7 billion.

Social Insurance Proposals

The President's budget proposes to extend coverage (thereby requiring contributions) in the Social Security (OASDHI) and unemployment insurance programs and increase rates in the railroad and civil service retirement programs. It also proposes to repeal the exemption of some earnings from the Social Security tax base. CBO estimates that these proposals, all requiring legislation, would increase revenues by $2 billion in 1988 and $14.6 billion over the 1988-1992 period (see Table III-7). Increased coverage by these programs under the President's proposals would raise benefits by only about $150 million over the 1988-1992 period, but benefits would grow as the newly covered workers age.

TABLE III-7. CBO ESTIMATES OF THE ADMINISTRATION'S SOCIAL INSURANCE PROPOSALS
(By fiscal year, in billions of dollars)

Proposal	1988	1989	1990	1991	1992	Cumulative Five-Year Changes
Require Medicare Contributions of State and Local Government Employees a/	1.3	1.9	1.9	2.0	2.1	9.3
Require Employer Tax on All Tips	0.2	0.3	0.3	0.3	0.3	1.4
Increase Railroad Pension Contributions	0.2	0.3	0.3	0.3	0.3	1.4
Require UI Contributions of Railroad Employees a/	0.1	0.1	0.1	0.1	0.1	0.6
All Other	0.2	0.3	0.4	0.4	0.4	1.8
Total	2.0	3.0	3.1	3.2	3.3	14.6

NOTE: Revenues are net of reduced income taxes. Benefit increases are not included.

a. The proposal would also extend coverage to these employees.

Of these proposals, by far the largest increase in revenues over the 1988-1992 period would be generated by requiring longer-term state and local government employees and their employers to make Hospital Insurance (HI, or Medicare) contributions. This proposal would bring into the Medicare system the largest employee group not yet covered by the program. CBO estimates that payroll taxes would increase by $1.3 billion in 1988 and $9.3 billion over the 1988-1922 period. Benefits would be boosted by about $40 million over the same period. The bulk of the increase in benefits flowing from the extension of coverage would occur in later years.

A similar proposal was introduced in the Senate in the last session of the Congress as an amendment to the Omnibus Budget Reconciliation Act of 1986, but the provision was deleted before the bill was enacted. State and local employees hired after March 31, 1986, are not affected by the proposal, since they were covered under HI in the Consolidated Omnibus Budget Reconciliation Act of 1985.

The President proposes to extend federal-state unemployment insurance (UI) coverage to employees in the railroad industry. This is the fourth budget to include the proposal. The Congress did not act on the earlier budget proposals, although reform of the railroad UI system was considered in the 99th Congress and is likely to be reconsidered this session. CBO estimates that the President's proposal would increase revenues by about $600 million and benefits by about $100 million over the 1988-1992 period.

The President also proposes to raise the railroad retirement system's private-pension equivalent (Tier II) tax rate by 3 percentage points in two steps in 1988 and 1989. An additional 1.1 percentage point increase in the rate is proposed, effective January 1, 1988, to increase the industry's share in the financing of vested dual--or windfall--rail retirement benefits. CBO estimates that the rate increases, which would result in a combined employee-employer Tier II rate of 23.1 percent, would increase payroll taxes by $1.4 billion in revenues over the 1988-1992 period.

The President's budget also proposes increasing Social Security revenues slightly by requiring employers to pay Federal Insurance Contributions Act (FICA) taxes on the total tip income of their employees, rather than on only the portion of tip income necessary to bring an employee's earnings up to the federal minimum wage. CBO estimates that this requirement would increase payroll taxes by $1.4 billion over the 1988-1992 period. Other social insurance proposals include extending FICA taxes to the inactive duty wages of military reservists, some student earnings, and other earnings now exempt from the FICA wage base, as well as the inclusion of some employer-provided group-term life insurance (over a floor) in wages for FICA purposes. CBO estimates that these proposals would raise $1.8 billion in revenues over the 1988-1992 period.

Black Lung Tax Proposals

The President proposes to increase the manufacturers' excise tax on sales of domestically mined coal by approximately 55 percent, to $1.70 per ton for coal from underground mines and 85 cents per ton for coal from surface mines, effective October 1, 1987. Rates would be reduced slightly after

three years. These excise taxes finance the Black Lung Disability Trust Fund, which provides benefits to miners who are disabled by black lung disease and are without other recourse for aid from a coal mine operator; it also provides aid to their dependents. The fund, which is running a deficit, has been granted a temporary moratorium on the interest it owes on advances from federal government general revenues. The rate increases are the main component in the Adminstration's proposed program for eliminating the fund deficit over the next 20 years. CBO estimates that the proposal would increase revenues by $0.3 billion in 1988 and $1.3 billion over the 1988-1992 period (see Table III-8).

The President's budget also proposes to require that the income-maintenance portion of Black Lung benefits (about 80 percent) be included in recipients' gross incomes for tax purposes. The portion of benefits that reimburses the recipient for medical costs would remain tax-exempt. CBO estimates that taxation of benefits would increase income taxes by about $0.6 billion over the 1988-1992 period.

TABLE III-8. CBO ESTIMATES OF THE ADMINISTRATION'S BLACK LUNG TAX PROPOSALS
(By fiscal year, in billions of dollars)

Proposal	1988	1989	1990	1991	1992	Cumulative Five-Year Changes
Increase Black Lung Excise Tax (Net)	0.3	0.3	0.3	0.3	0.3	1.3
Include Some Black Lung Benefits in Gross Income for Tax Purposes	a/	0.2	0.1	0.1	0.1	0.6
Total	0.3	0.5	0.4	0.4	0.4	2.0

a. Revenue increase of less than $50 million.

Excise Tax and Fee Proposals

The remaining Administration revenue proposals would raise approximately $5 billion over the 1988-1992 period (CBO's estimate), about half from fees and half from repeal of Highway Trust Fund tax exemptions. By 1990, the proposed fees would raise more revenue than the Highway Trust Fund changes (see Table III-9).

At present, state and local governments are exempt from all Highway Trust Fund taxes. Gasohol and methanol (fuels containing alcohol) are partially exempt from the gasoline and diesel fuel taxes. Most bus operators are exempt from highway taxes. The President's budget proposes repeal of these exemptions. (Last year's budget proposed repeal of some exemptions.) CBO estimates that elimination of the alcohol fuel and bus exemptions would increase revenues by $0.2 billion in 1988 and $0.8 billion over the 1988-1992 period. Elimination of the state and local government exemp-

TABLE III-9. CBO ESTIMATES OF THE ADMINISTRATION'S EXCISE TAX AND FEE PROPOSALS
(By fiscal year, in billions of dollars)

Proposal	1987	1988	1989	1990	1991	1992	Cumulative 1987-1992 Changes
Eliminate Highway Tax Exemptions (Net)	n.a.	0.5	0.5	0.5	0.5	0.5	2.5
Adjust and Extend Customs User Fee (Net)	a/	a/	b/	0.4	0.4	0.4	1.3
Other Fees	0.1	0.2	0.2	0.3	0.3	0.3	1.3
Total	0.1	0.8	0.7	1.1	1.2	1.2	5.1

NOTE: n.a. = not applicable.

a. Revenue increase of less than $50 million.
b. Revenue decrease of less than $50 million.

tions, according to CBO, would increase revenues by $0.3 billion in 1988 and $1.7 billion over the 1988-1992 period, which is $0.6 billion less than the Administration's estimate for 1988 through 1992.3/ These estimates are measures of the unified budget effects of the proposals. Excise tax increases are associated with much smaller income tax reductions,. These reductions produce revenue increases in the unified budget that are somewhat smaller than the excise tax increases.

About half of the proposed revenues from new and increased fees proposed in the President's budget would result from adjusting and extending the Customs Service user fee recently enacted in the Omnibus Budget Reconciliation Act of 1986. The proposal would ensure that revenues fully cover the commercial operating costs of the Customs Service. The Administration also proposes extending the fee beyond its present expiration date of September 30, 1989. CBO estimates that the proposal would increase unified budget revenues by about $40 million in 1988 and by about $1.3 billion over the 1987-1992 period. The fee increase itself would raise about $1.7 billion for the Customs Service over the six-year period.

Other fees and user charges in the President's budget program would raise $0.2 billion in revenues in 1988 and $1.3 billion over the 1987-1992 period. Over half of these--including fees for nuclear facility regulation, federal emergency management assistance, and the issuance of fishing licenses, and the IRS user charges--are similar to proposals in last year's budget.

3. Highway Trust Fund excise taxes are scheduled to expire after September 30, 1988. Both CBO and the Administration revenue projections assume extension of these taxes at current tax rates through 1992.

CHAPTER IV

THE ADMINISTRATION'S DEFENSE BUDGET

The Administration's defense budget for fiscal year 1988 calls for increases in budget authority above the CBO baseline projections of $9 billion in 1988 and $110 billion over the 1988-1992 period. The higher appropriations sought by the Administration would raise outlays above CBO's baseline projections by $8 billion in 1988 and by $72 billion from 1988 through 1992.

In contrast with its baseline projections, CBO estimates outlays assuming the President's proposals are enacted. Last year, these reestimates showed outlays much greater than the Administration estimated. This year, however, the CBO and the Administration estimates of outlays resulting from the President's request are approximately the same.

The Administration's 1988 budget authority proposals have a different mix of programs from those the Congress approved for 1987 and CBO projected into 1988. Proposed procurement appropriations are lower--in both relative and absolute terms--while those for operation and maintenance and research and development are larger. This proposed shift in the defense budget's composition raises outlays because the increases are planned in programs that result in relatively immediate outlays, while the decrease in procurement will not lower outlays until later.

DEFENSE FUNDING LEVELS

The Administration's budget request of $312 billion in budget authority for the national defense function for 1988 represents an increase of $22 billion over 1987 appropriations and $9 billion over the CBO baseline. After adjusting for expected inflation, the Administration request translates into 3 percent real growth over 1987. Over the five-year period, 1988-1992, the Administration's budget would produce an annual average of about 2 percent real growth using CBO's projected inflation rates (see Box IV-1).

BOX IV-1
INFLATION AND REAL GROWTH IN THE DEFENSE BUDGET

The annual budget request for the Department of Defense (DoD) includes funds to cover anticipated inflation. The request is for new budget authority, which represents the right to enter into contracts to buy goods and services. Since these contracts, in particular those for major weapons such as ships, tanks, and aircraft, can extend over several years, budget authority to fund the estimated costs of inflation must also extend over the life of each contract. Thus, the amount of the DoD budget request that represents future price changes is substantial.

Both CBO and the Administration base their estimates for price changes affecting the defense budget on their overall economic forecasts. The following table shows CBO and Administration estimates for all defense purchases less compensation. The differences are very close to the differences between CBO and Administration estimates of the GNP deflator (see Chapter II).

Comparison of CBO and Administration Inflation Assumptions for Defense Purchases (By fiscal year, in percent change, purchase deflator for outlays)

	1987	1988	1989	1990	1991	1992
CBO	2.5	3.5	4.1	4.2	4.2	4.2
Administration	2.2	3.8	3.7	3.4	3.0	2.5

Pay raises pose a unique problem in that they are treated as administered price changes. Real growth in military personnel is determined by increases in strengths; in the short term, pay raises do not affect strength and quality appreciably and are a suitable proxy for price changes. In the long run, differences in pay between federal and private employees can make a difference in measuring real growth because quantity and quality have time to change.

Most interest in aggregate real growth focuses on budget authority and requires use of budget authority deflators rather than outlay deflators--the latter being more relevant for comparisons with other price indexes. Budget authority deflators are a weighted average of outlay deflators reflecting price changes over the period when funds are spent. Based on the Administration's pay assumptions and the forecast of the CBO for other defense purchases, real growth in budget authority will average about 2 percent from 1988 through 1992.

This year the Department of Defense (DoD) budget also contains a request for 1989 as required by law (Public Law 99-145). Consequently, there is more detail available for the Administration's longer-term plans (see Table IV-1). Overall, however, the 1989 request--$332 billion--exceeds the CBO baseline by $16 billion and the Administration's 1988 request by $20 billion. Over the period of 1988 through 1992, the real growth in budget authority would continue the trend of annual real increases since 1980 (with the exception of 1986 and 1987 when the defense budget declined about 2 percent in real terms each year). The real decline in 1986 came after a 9 percent average annual real growth in the previous five years.

The request for 1988 also continues a slight shift in the composition of budget authority. From 1980 through 1985, the defense budget became more heavily weighted toward spending for investment, with the procurement accounts growing the most--from about 25 percent in 1980 to almost 33 percent in 1985. But, in 1986 through 1987, real procurement funding fell by 12 percent. The 1988 request calls for real decline of about 5 percent in 1988 before resuming growth averaging about 6 percent over the next four years. Operation and maintenance (O&M) and research, development, test, and evaluation (RDT&E) would receive by far the largest increases. The request for O&M calls for real growth of 4 percent, or about $3 billion, while the RDT&E request calls for real growth of 17 percent, or about $6 billion. Like procurement, O&M would experience real growth over the five-year period, but RDT&E would see real decline after 1988.

ESTIMATES FOR DEFENSE OUTLAYS

CBO and Administration estimates for outlays are much closer than they were a year ago. At that time, the Administration doubted the relevance of the historical spending patterns that it had previously used to estimate future outlays and thus abandoned them. CBO, however, continued to use these patterns. Last year, according to CBO estimates, outlays were $11 billion to $18 billion higher than those estimated by the Administration in each year of the five years covered by the 1987 budget. This year, the estimates for the 1988 budget differ by no more than $1.1 billion per year because the Administration has resumed its use of historical spending or outlay rates in making its estimates. Note that in reestimating the President's defense request, CBO assumes almost the same budget authority as the request--there are only relatively small differences related to offsetting receipts, pay raises, and G.I. Bill funding. (See Appendix B for more discussion of outlay reestimates.)

Outlays under the Administration's budget, as reestimated by CBO, would increase $19 billion in 1988 over the level estimated by CBO for 1987. Compared with 1987 outlays--estimated to be about $279.6 billion--

TABLE IV-1. MAJOR SPENDING PROPOSED IN ADMINISTRATION'S 1988 BUDGET FOR FUNCTION 050: NATIONAL DEFENSE (By fiscal year, in billions of dollars)

Account	1988	1989	1990	1991	1992	Five-Year Totals
Budget Authority						
Military Personnel	76.3	76.6	78.3	78.9	79.3	389.5
Operation and Maintenance	86.1	90.0	96.5	101.7	106.7	481.0
Procurement	84.1	94.6	105.6	115.6	123.3	523.2
RDT&E a/	43.7	44.2	39.6	39.7	42.3	209.4
Military Construction	6.6	6.9	7.5	7.7	8.5	37.1
Other-DoD	6.3	10.5	15.9	20.8	25.8	79.3
Subtotal	303.1	322.9	343.4	364.3	385.8	1,719.6
Other Defense	8.7	9.1	9.6	10.1	10.4	47.8
Administration's 1988 Budget as Reestimated by CBO	311.8	332.0	353.0	374.4	396.2	1,767.3
Outlays						
Military Personnel	75.5	76.0	77.6	78.2	78.6	385.9
Operation and Maintenance	82.7	87.2	93.5	98.8	103.8	466.0
Procurement	82.7	84.1	90.1	98.3	106.2	461.3
RDT&E a/	38.3	41.4	39.7	38.3	39.3	197.0
Military Construction	5.2	5.8	6.4	6.8	7.3	31.5
Other-DoD	5.5	9.7	14.8	19.8	24.9	74.7
Subtotal	289.9	304.1	322.1	340.3	360.1	1,616.5
Other Defense	8.3	8.5	9.0	9.5	9.9	45.2
Administration's 1988 Budget as Reestimated by CBO	298.3	312.6	331.1	349.8	369.9	1,661.7

SOURCE: Congressional Budget Office.

a. Research, development, test, and evaluation.

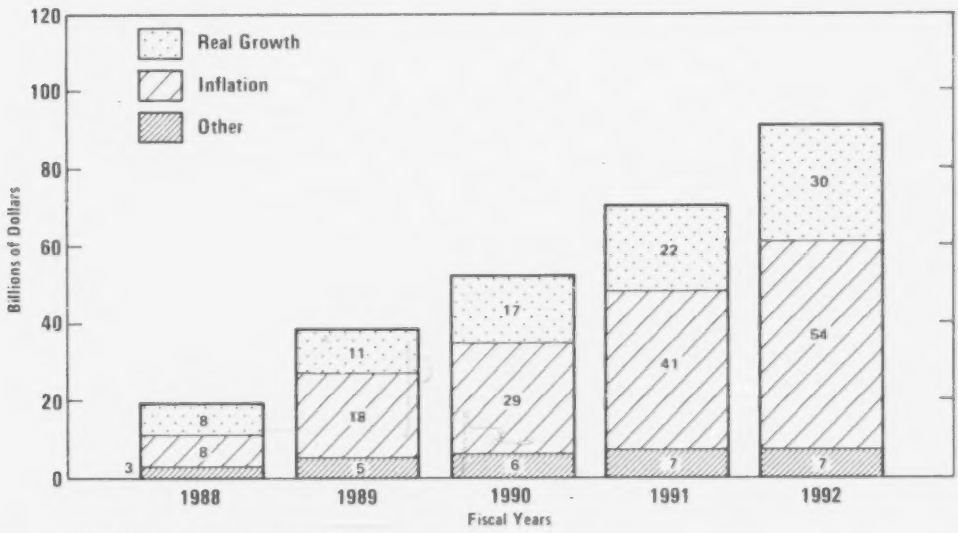
outlays would grow by about $3 billion as the result of past increases in budget authority (and assuming that budget authority in 1988 was held at the 1987 level). Covering the costs of inflation would add about $8 billion. The final $8 billion of outlay growth estimated for 1988 would stem from the real growth in budget authority. Sources of outlay growth are shown in Figure IV-1.

The future pattern of outlay growth under the Administration's budget proposals shows that the largest growth is attributable to meeting the costs of inflation. Over the five years, outlays would grow by $264 billion over the 1987 level. About 57 percent of the increase, or about $150 billion, would result from expected price growth. Another 34 percent, or $87 billion, would represent real growth in budget authority and the remaining 9 percent, or $28 billion, would occur if budget authority remained frozen at the 1987 level.

Table IV-2 shows major spending changes proposed in the Administration's budget and helps to illustrate the different spending patterns for

Figure IV-1.

Sources of Outlay Growth in Defense Outlays, Fiscal Years 1987-1992



SOURCE: Congressional Budget Office.

TABLE IV-2. MAJOR SPENDING CHANGES PROPOSED IN ADMINISTRATION'S 1988 BUDGET FOR FUNCTION 050: NATIONAL DEFENSE (By fiscal year, in billions of dollars)

Changes	1988	1989	1990	1991	1992	Five-Year Totals
Budget Authority						
CBO Baseline	302.7	316.3	330.6	345.8	361.7	1,657.1
Proposed Changes						
Military personnel	1.3	1.7	3.3	3.9	4.1	14.3
Operation & maintenance	3.3	4.8	8.6	11.4	13.8	41.9
Procurement	-4.7	2.3	9.5	15.4	19.1	41.6
RDT&E a/	6.3	5.4	-0.8	-2.3	-1.4	7.2
Military construction	1.4	1.5	1.9	1.9	2.5	9.1
Other-DoD	1.1	-0.4	-0.8	-2.4	-4.1	-6.5
Subtotal	8.7	15.3	21.8	27.9	33.9	107.6
Other Defense	0.4	0.4	0.6	0.7	0.6	2.6
Total Changes	9.1	15.7	22.4	28.6	34.5	110.3
Administration's 1988 Budget as Reestimated by CBO	311.8	332.0	353.0	374.4	396.2	1,767.3
Outlays						
CBO Baseline	290.5	303.4	317.1	332.2	346.9	1,590.1
Proposed Changes						
Military personnel	1.2	1.6	3.2	3.8	4.1	14.0
Operation & maintenance	2.3	3.9	7.5	10.5	13.0	37.1
Procurement	-0.3	-1.5	1.1	5.0	9.9	14.2
RDT&E a/	3.5	5.1	2.0	-1.0	-1.5	8.1
Military construction	0.2	0.7	1.2	1.5	1.8	5.4
Other-DoD	0.8	-0.6	-1.3	-2.6	-4.5	-8.2
Subtotal	7.7	9.2	13.8	17.2	22.8	70.7
Other Defense	0.1	b/	0.2	0.3	0.2	0.9
Total Changes	7.8	9.2	14.0	17.5	23.1	71.6
Administration's 1988 Budget as Reestimated by CBO	298.3	312.6	331.1	349.8	369.9	1,661.7

SOURCE: Congressional Budget Office.

a. Research, development, test, and evaluation.

b. Less than $50 million.

various defense budget accounts. For example, the $4.7 billion decrease in procurement budget authority in 1988 results in only a $0.3 billion decline in outlays in 1988, while effecting a $1.5 billion decline in 1989 despite a budget authority increase that year. In contrast, the budget authority increases in O&M and RDT&E in 1988 raise outlays immediately.

The significance of the compositional shift noted above can be seen most clearly when outlays are considered and when the CBO baseline is used as a reference. The baseline represents a no-real-growth projection in which the composition of the defense budget is held constant according to the 1987 distribution of budget authority; that is, no defense budget account changes in real terms. Differences between the request and the baseline represent changes in real terms both in total budget authority and in budget composition (see Table IV-2).

The Administration has claimed that recent budget resolutions have not recognized the appropriate mix of operating and investment resources so that there has been a mismatch between budget authority and outlays--specifically, that outlays in the resolution were too low relative to the budget authority. Like last year, the Administration proposes a budget with increases in the fast spending accounts so the perceived mismatch could occur again. As an illustration, in 1988, the $9.1 billion increase in budget authority from the CBO baseline would necessitate a $7.3 billion increase in outlays for a marginal outlay rate of 80 percent (the supplemental request for 1987 raises 1988 outlays by $0.6 billion--see Box IV-2). In contrast, an across-the-board increase would have a marginal outlay rate of 58 percent; an increase in nonpay defense budget authority would have a 38 percent rate; and, increases in the slowest spending account--weapons procurement--would have a 13 percent rate.

Ultimately, of course, whether there is a mismatch or not is a policy choice over how funding should be allocated in the face of programmatic and deficit pressures. In establishing the defense outlay targets in the Congressional budget resolutions, the Budget Committees must consider not only the total level of defense resources but also their distribution among the different components of the defense budget--and, implicitly the marginal outlay rate.

MAJOR DEFENSE PROPOSALS

The defense budget serves the national security objectives of the United States by supporting a variety of land, air, and naval forces. Under the

Administration's budget, most major force categories would increase in 1988 and 1989 as shown in Table IV-3. In addition to greater numbers, forces would be modernized; for example, M-60 tanks now in the Army's inventory would be replaced with new M-1 tanks. Also, increases in manpower might make some units more effective even though the number of units was unchanged.

Spending for military personnel and O&M fund the operations and readiness of currently deployed forces. Military personnel pays for those

BOX IV-2
THE ADMINISTRATION'S REQUEST FOR SUPPLEMENTAL 1987 APPROPRIATIONS FOR DEFENSE

The Administration has requested supplemental appropriations totaling about $3.4 billion for 1987. The supplemental has two basic parts--the common pay and program supplemental and one for the costs of Federal Employees' Retirement Act of 1986. Together these supplementals result in additional outlays of $1.7 billion in 1987 and $0.6 billion in 1988.

The table below shows the composition of the basic supplemental request. The $500 million requested for research, development, test and evaluation for the Strategic Defense Initiative is the largest single item in the request. Another $500 million would be spent on dismantling aging chemical weapons, $250 million for procurement, and $250 million for military construction. Additional funds are sought to fund fully the military pay raise mandated for fiscal year 1987. This raise was not fully funded in the fiscal year 1988 appropriation bill, thus requiring reductions in other areas. Operations and Maintenance funds would be used to fund, in part, the CHAMPUS health-care program and to increase the flying hours, steaming hours, and spare parts necessary for global training exercises.

1987 Supplemental Request
(In millions of dollars)

Military Personnel	443
Operations and Maintenance	603
Procurement	804
Research and Development	694
Military Construction	250
Total Budget Authority	2,794

The Administration also requests about $565 million to fund the 1987 costs of recent legislation raising the government's contributions to federal civilian retirement. Together with the program supplemental described above, this brings the Administration's supplemental request to about $3,359 million.

TABLE IV-3. SUMMARY OF ACTIVE FORCES (By fiscal year, in numbers)

Active Forces	1986 Actual	Projected 1987	1988	1989
Strategic Forces				
Land-based ICBMs	1,007	1,000	1,000	1,000
Strategic bombers	259	292	324	324
Sea-launched missiles	464	528	560	592
Strategic interceptors	76	54	36	36
General Purpose Forces				
Army divisions	18	18	18	18
Marine Corps divisions	3	3	3	3
Air Force tactical aircraft	1,764	1,812	1,762	1,774
Navy tactical aircraft	758	752	758	758
Marine Corps tactical aircraft	333	331	346	351
Naval Forces				
Aircraft carriers	13	14	14	14
Battleships	3	3	3	4
Nuclear attack submarines	97	97	99	101
Other warships	211	214	214	218
Amphibious assault ships	60	61	62	65
Airlift and Sealift Forces				
C-5 aircraft	71	80	98	110
Other Air Force aircraft	786	850	812	804
Navy and Marine Corps tactical support ships	88	88	92	92
	64	61	61	61

SOURCE: Compiled by Congressional Budget Office based on data supplied by the Department of Defense.

NOTE: Aircraft are in terms of primary authorized aircraft.

people on active and reserve duty, and O&M finances a wide range of logistical and personnel support functions. The procurement accounts contribute to force operations and readiness with funds for spare parts.

The force growth projected for 1988 results from past decisions to procure ships, aircraft, and vehicles. The improvements in quality of weapons stems from past decisions to pursue technological initiatives with RDT&E funding.

Table IV-4 illustrates the pattern of real growth over the projection period in the appropriation categories used by the Congress. The table shows that growth in military personnel and operation and maintenance--the so-called readiness accounts--is fairly steady, but there is more variation in the other accounts. Procurement funding would be depressed in 1988, but grow thereafter while RDT&E, military construction, and family housing follow an opposite pattern--rapid growth followed by more moderate growth and, in the case of RDT&E, real decline. The following sections of this chapter discuss these changes in more detail.

Military Personnel

Military personnel appropriations fund the pay and allowances of members of the active and reserve forces. The Administration has requested $2.5 billion more in 1988 than was appropriated for these accounts in 1987 and $1.3 billion more than the CBO baseline--for a total of $76.3 billion. This amount does not include the cost of the Administration's proposed 4 percent pay raise--about $2 billion. Also, the request does not include cuts in officer strength required by the Defense Authorization Act for 1987, 1988, and 1989.

Table IV-5 shows that strength levels for active units would fall by 2,000 people in 1988 though reserve-unit strengths would rise. This would be the first overall active strength reduction since 1979 and results from a decrease in Air Force personnel. The reduction of 8,150 in the Air Force is the net result of reducing the training pipeline, tactical air forces mobility forces, and support activities by 12,100 people and of increasing personnel allotted to the B-1, special operations forces, ground launched cruise missiles, and medical programs by 3,950.

The Navy and Army have requested overall increases for a variety of programs. The Navy wants to enlarge active strength by 6,200 to support the growth in the active fleet from 569 ships in 1987 to 582 ships in 1988.

The major part of this growth would be used to man new ships and aircraft squadrons and to meet other fleet requirements, such as maintenance activities, undersea surveillance, ordnance disposal, and special warfare. The Army's personnel strength shows a very small increase, and the Marine Corps strength request maintains 1987 levels.

TABLE IV-4. REAL PERCENT CHANGES IN DEFENSE BUDGET AUTHORITY BY APPROPRIATION CATEGORIES
(By fiscal year, in percents)

Category	Actual 1980-1986 Average	Projected 1987	Projected 1988	Projected 1989	Projected 1989-1992 Average
Department of Defense					
Military Personnel	2	1	2	1	1
Operation and Maintenance a/	5	1	4	2	3
Procurement	11	-7	-5	8	5
RDT&E b/	11	4	17	-3	-5
Military Construction	10	-8	26	1	4
Family Housing	6	9	8	2	1
Other-DoD	11	c/	c/	c/	c/
Subtotal-DoD	7	-2	3	2	2
Other Defense	11	d/	5	d/	d/
Total, National Defense	7	-2	3	2	2

SOURCE: Compiled by Congressional Budget Office based on data supplied by the Department of Defense.

a. This table does not reflect the fact that in 1987, the DoD expects to transfer about $5 billion out of other accounts into operation and maintenance. If the transfers take place, real growth in O&M will be higher in 1987 and lower in 1988 than shown here; but these changes to O&M would be offset by changes elsewhere in the budget.

b. Research, development, test, and evaluation.

c. Because this category includes offsetting receipts and other miscellaneous accounts, real growth in percentage terms is misleading.

d. Less than 0.5 percent.

The Defense Authorization Act for 1987 requires that active officer end strengths be reduced by 6 percent by 1989--1 percent in 1987, 2 percent in 1988, and 3 percent in 1989--to achieve a ratio of 6.4 enlisted personnel to each officer. Since no reductions were made in active officer personnel for 1987, and none is included in the 1988 budget request, the ratio remains at 5.9 enlisted personnel per officer. Meeting the reductions stipulated by law would save about $280 million from the 1988 request.

The 1988 request would raise the reserve component end strength by 32,964--a 4,750 increase in full-time and a 28,214 increase in part-time personnel. While this is an overall increase of 2.8 percent, it is proportionally larger among full-time personnel--6.9 percent compared with 2.6

TABLE IV-5. REQUESTED STRENGTH LEVELS FOR MILITARY PERSONNEL (By fiscal year)

Service	1988 Request (Thousands of people at year end)	Percent Change Between Years 1986-1987	1987-1988	1988-1989
Active				
Army	781	a/	a/	a/
Navy	593	2.9	1.1	1.6
Marine Corps	200	0.8	0.0	0.3
Air Force	599	-0.2	-1.3	0.3
Subtotal	2,173	0.8	-0.1	0.6
Reserves				
Full-time	74	8.6	6.9	6.2
Part-time	1,117	2.0	2.6	1.7
Subtotal	1,190	2.4	2.8	1.9
Total	3,363	1.3	0.9	1.0

SOURCE: Compiled by Congressional Budget Office based on data supplied by the Department of Defense.

a. Less than 0.5 percent.

part-time reserves. Most of the growth in full-time reservists--the more costly soldiers--would occur in the Army and Marine Corps reserves, both at 15 percent. The Army Reserve justifies this growth in terms of improved unit and individual training, mobilization capability, unit retention, and unit administration. The Marine Corps increase would support two light armored vehicle companies, a target acquisition battery, a helicopter squadron, and other functions.

The proposed $2.5 billion increase in military personnel appropriations over 1987 has many components, the largest of which are related to personnel strength changes. The strength changes proposed for 1988 would cost $110 million--$165 million in additional costs for reserve forces and $53 million in savings for active forces. Annualization of last year's growth in strength would add about $440 million while another $300 million of the increase would come from other strength-related sources, such as growth in grade.

Other funding increases include $504 million for the annualization of the 1987 pay raise, $391 million in the payment of social security wage credits, $262 million in increases for active enlistment and reenlistment bonuses, $81 million for permanent change of station (PCS), and $80 million for cost growth in variable housing allowances. Also the request includes a reduction of $84 million for educational benefits (G.I. Bill). The administration will submit legislation to continue the G.I. Bill, but will also introduce legislation to reduce benefit levels.

Operation and Maintenance

The operation and maintenance (O&M) account funds a wide range of activities--some directly related to force operations, such as training exercises, weapons maintenance, supplies, and other general logistical support. O&M also funds personnel support activities--such as training of individual members (apart from training in units), medical care, and military base or community services--which are only indirectly related to force readiness. Overall, new budget authority would grow by about 4 percent in real terms in 1988. As shown in Table IV-6, not all O&M programs share in the real growth--three major force programs and administration decline while central supply and maintenance grows by 14 percent.

The Administration's O&M budget shows real decline in funds for strategic forces, general purpose forces, and airlift/sealift--the program for moving forces over long distances. Navy funding in the three major force programs declines by $1.7 billion, or 12 percent, in real terms despite the

movement toward the Navy's goal of 600 ships. It is unclear at this time what efficiencies or program reductions might account for this decline except that about $700 million of it can be attributed to reduced depot maintenance--extensive and relatively infrequent overhauls that are not indicative of short-term force support. The Air Force shows real increases in the

TABLE IV-6. REAL CHANGES IN OPERATION AND MAINTENANCE (By fiscal year, in billions of dollars and percents)

Activity	1988 Request (Dollars)	Real Changes a/ 1986-87 (Percent)	1987-1988 Percent	1987-1988 Dollars	1988-89 (Percent)
Strategic Forces	5.0	-3	-2	-0.1	5
General Purposes Forces	25.5	2	-1	-0.4	3
Intelligence and Communications	8.5	7	2	0.2	2
Airlift and Sealift	1.6	-8	-12	-0.2	5
Reserve Forces	6.8	5	4	0.3	4
Central Supply and Maintenance	21.2	-4	14	2.6	-2
Training, Medical and Other	13.8	4	7	0.9	3
Administration and Associated	3.4	9	-2	-0.1	1
Support of Other Nations	0.2	25	5	b/	3
Total	86.1	1	4	3.3	2

SOURCE: Compiled by Congressional Budget Office based on data supplied by the Department of Defense.

a. This table does not reflect the fact that in 1987, the DoD expects to transfer about $5 billion out of other accounts into operation and maintenance. If the transfers take place, real growth in O&M will be higher in 1987 and lower in 1988 than shown here; but these changes to O&M would be offset by changes elsewhere in the budget.

b. Less than $50 million.

force programs consistent with its force growth and other programmatic increases. Army and Marine Corps funding are more difficult to summarize in relation to forces because force measurement is so highly aggregated, but Army funding in the three major program areas--strategic, general purpose, and airlift/sealift--declines slightly, while Marine Corps funding rises slightly, in real terms.

The largest growth in O&M budget authority is in central supply and maintenance activities, but the actual program may not be much larger in 1988 than 1987. In 1987, this O&M program received not only new budget authority but also access to about $5 billion in unobligated balances--particularly from stock and industrial funds--whose availability primarily affects this activity. This, focusing just on budget authority understates real growth in 1987 and overstates real growth in 1988.

The growth in the other O&M activities is spread across a broad range of programs. Training of individual servicemen--in contrast with training exercises for units--receives greater funding in 1988 for specialized skills, flight training, and other training for members, but funding also increases for dependent schools. Medical funding increases for many reasons, including a program to increase the capacity and capability to deliver health care by contracting for personal services.

Procurement

The procurement account funds the purchase of weapons and other equipment. The weapons purchased in this account include new ships, aircraft, missiles, and combat vehicles like tanks. The procurement account also funds major modification or weapons improvement programs as well as spare and repair parts. Other purchases include trucks, bridging equipment, radios, and satellites. As shown in Table IV-4, the procurement accounts are the only major funding category for which the 1988 budget request contains a real decline in budget authority--about 5 percent. The Administration's procurement request for 1988 implies three successive years of real decline after growing at a 15 percent average annual rate in the preceding five years. (The Congressional appropriations for 1986 and 1987 represented real declines in procurement funding.) In 1989, the proposal would resume real growth in all categories of procurement (see table IV-7).

For many weapons, the Administration proposes buying fewer weapons in 1988 than in 1987. Such slowdowns can portend either program terminations--such as the Army's Apache attack helicopter--or stretch-outs by

TABLE IV-7. REAL CHANGES IN PROCUREMENT BUDGET AUTHORITY (By fiscal year, in billions of dollars of budget authority and percents)

Activity	1988 Request (Dollars)	Real Changes a/ 1986-87 (Percent)	1987-1988 Percent	1987-1988 Dollars	1988-89 (Percent)
Support and Other Equipment b/	20.5	5	-9	-2.0	17
Aircraft	14.0	-31	-10	-1.6	1
Shipbuilding and Conversion	11.1	3	4	0.4	3
Other Missiles, Torpedoes, and Weapons	9.6	-10	13	1.1	11
Communications and Electronic Equipment	8.0	4	c/	d/	13
Spares and Repair Parts	5.9	-9	-6	-0.4	c/
Vehicles, All Types e/	4.4	-11	-15	-0.8	3
Modifications	3.5	-3	-37	-2.1	18
Ammunition, Munitions, and Related Equipment	3.3	-6	-16	-0.6	5
Ballistic Missiles	3.6	47	38	1.0	2
Total	84.0	-7	-5	-4.8	8

SOURCE: Compiled by Congressional Budget Office from data supplied by the Department of Defense.

a. Real growth computed using CBO's economic assumptions and the President's pay-raise assumptions.
b. Includes Defense Agency purchases of National Guard and Reserve equipment in 1986 and 1987.
c. Less than 0.5 percent.
d. Less than $50 million.
e. Includes Army weapons and tracked combat vehicles, but excludes all Navy, and Defense Agency purchases of National Guard, and Reserve vehicles, which are included in Support and Other Equipment.

which the same total quantity of a weapon is purchased over a longer period of time--for example, the AV-8B aircraft. Production slowdowns add to unit costs as fixed costs are spread over fewer systems and economies of large-scale production go unrealized. CBO is currently assessing the effects of stretch-outs on weapons costs, but preliminary results suggest that effects vary widely, with costs of some systems appearing to be relatively insensitive to production rates, while others show significant savings when produced at higher rates. The following discussions of aircraft, missile, and vehicle procurement highlight some of the wide variations in unit costs that can be attributable to some combination of production slowdowns and other program changes--for example, procurement of an improved weapon.

Support Equipment. The largest single activity within the defense procurement accounts for 1988 is support and other equipment. Its large absolute and relative size stems from the fact that "other equipment" is itself a large category and that all major weapons systems require general and sometimes specialized equipment for maintenance and test purposes. (CBO has included Defense Agency purchases of National Guard and Reserve equipment in this category. These purchases include everything from photographic equipment and vehicles to training devices, missiles, and aircraft. Budget details were not available to permit a breakout of the data.) While not a part of actual weapons systems, support equipment is an important part of all weapons programs. In real terms, this category was one of four having real growth in 1987, but in 1988, it will decline by 9 percent before rising by 17 percent in 1989.

Aircraft. Aircraft procurement--the second largest category in procurement--would decline for three consecutive years as the total number of aircraft purchased declined from 939 in 1986 to 765 in 1987, to 652 in 1988, and to 603 in 1989. The overall decline in funding can be traced to the conclusion of one program--the C-5B transport which received $1.9 billion for procurement of 21 aircraft in 1987, but would receive nothing in 1988. Similarly, KC-10 tanker procurement would end with the eight procured for $87 million in 1987. Except for new programs, only two weapons systems--the SH-60F helicopter and the A-6E/F aircraft--are requested in greater quantity in 1988 than 1987. As shown in Table IV-8, seven of the remaining fourteen systems have quantities reduced by 20 percent to 65 percent; in all but one of these cases unit costs rise significantly. Whether or how much of the unit cost increases stem from slowed production is unclear; of six systems with no quantity change, unit costs are increased for three systems and decreased for the other three. For at least two aircraft--the A-6 attack aircraft and the F-14 fighter--newer models would be purchased in 1988; such changes in quality or capability may be the source of some increases in unit cost.

TABLE IV-8. SELECTED PROGRAM CHANGES IN THE 1988 REQUEST FOR AIRCRAFT PROCUREMENT (By fiscal year, in millions of dollars of budget authority and percents)

Weapon	1988 Request		Percent Changes from 1987	
	Quantity	Dollars	Quantity	Unit Cost
Increases				
SH-60F Helicopter	18	330	157	-21
A-6E/F Aircraft	12	853	9	110
Decreases				
EA-6B Aircraft	6	357	-50	61
F-14A/D Aircraft	12	829	-20	56
E-2C Aircraft	6	427	-40	45
SH-60B Helicopter	6	144	-65	36
AV-8B Aircraft	32	700	-24	24
UH-60 Helicopter	61	480	-26	21
AH-64 Helicopter	67	746	-34	-5
No Changes				
F-15 Aircraft	42	1,655	a/	-8
E-6A Aircraft	3	347	a/	-8
Civil Air Patrol Aircraft	38	1	a/	-64
MC-130H Aircraft	7	403	a/	24
CH/MH-53E Helicopter	14	255	a/	16
F/A-18 Aircraft	84	2,580	a/	1
F-16 Aircraft	180	2,885	a/	a/

SOURCE: Compiled by Congressional Budget Office from data supplied by the Department of Defense.

a. No change.

Shipbuilding. The Administration's request of $11 billion for shipbuilding and conversion includes $9.8 billion for new construction of 16 ships, $0.8 billion for conversion of 4 ships, and $0.5 billion for outfitting, post delivery, and other craft. The major increases over 1987 are $644 million in anticipation of future funding requests for two nuclear aircraft carriers (1988 funding would be for items requiring advance procurement) and $730 million to extend the service-life of the U.S.S. Kitty Hawk aircraft carrier. The DoD asserts that to sustain a force of 15 aircraft carriers into the next century, and to maintain a stable work force, the Navy plans to request two carriers--one in 1990 and the other in 1993. The construction of these ships would begin as soon as the two that were authorized in 1983 are delivered. Plans to build these carriers were not included in last year's five-year defense plan.

Missiles. The Administration's request for other missiles, torpedoes, and weapons procurement increases in real terms by 13 percent in 1988 and 11 percent in 1989, after a 10 percent decline in 1987. The request for 1988 calls for 115,134 tactical missiles compared with 104,068 in 1987. Seventeen of 24 weapons in this category would be procured at higher rates and 11 of these would experience declines in unit costs. For five of the seven systems procured at a slower rate, unit costs would increase (see Table IV-9). The largest cost growth would occur for the Sidewinder missile (156 percent) and the IIR Maverick missile procured by the Navy (105 percent). The Army, Navy, and Marine Corps all procure the Stinger missile and show declines in unit costs, but the Army's costs decline by 35 percent, the Marine Corps' by 13 percent, and the Navy's by 9 percent. In contrast, the Air Force would procure HARM missiles at unit prices 11 percent lower than last year, but the Navy expects prices to be 7 percent higher.

Communications Equipment. The funding request for communications and electronic equipment, ranging from radios for tactical forces to remotely piloted vehicles, totals $8 billion in 1988. After adjusting for inflation, this is the same real level as 1987. The largest single program is the Army's Mobile Subscriber Equipment (MSE)--field telephones--which accounts for $1 billion of the $8 billion total. MSE funding would increase by about $100 million over 1987 and a wide variety of other tactical programs in the Army would receive another $650 million in real funding growth. The Army's increases are offset by reductions to Navy and Air Force programs.

Spare Parts. Funding for procurement of spares and repair parts would decline by about 6 percent in real terms in 1988. Proposed funding for Army, Navy, and Air Force aircraft spares as well as funding for Navy and Air Force missile spares would decline.

TABLE IV-9. SELECTED PROGRAM CHANGES IN THE 1988 REQUEST FOR OTHER MISSILES, TORPEDOES, AND WEAPONS PROCUREMENT (By fiscal year, in millions of dollars of budget authority and percents)

Weapon	1988 Request		Percent Change from 1987	
	Quantity	Dollars	Quantity	Unit Cost
Increases				
AMRAAM Missile	630	837	250	-59
MK-48 Torpedo	100	256	100	-48
Stinger Missile (Army)	4,200	200	1	-35
Harpoon Missile	124	172	29	-32
Phoenix Missile	430	399	110	-31
ALWT Torpedo	153	227	292	-17
IIR Maverick Missile (Air Force)	2,100	364	5	-12
Stinger Missile (Marine Corps)	3,067	137	121	-13
HARM Missile (Air Force)	1,748	432	26	-11
Tomahawk Missile	475	1,016	47	-8
Patriot Missile	715	985	2	-7
IIR Maverick Missile (Navy)	601	104	43	105
TOW 2 Missile (Army)	9,416	140	1	19
Sparrow Missile (Air Force)	558	100	60	8
Sidearm Missile	276	26	8	4
Hawk Missile	525	162	22	4
Sidewinder Missile (Air Force)	956	53	29	--
Decreases				
Sidewinder Missile (Navy)	288	43	-54	156
Ground-Launched Cruise Missile	37	77	-51	24
TOW 2 Missile (Marine Corps)	2,680	27	-18	18
Laser Maverick Missile (Navy)	1,099	117	-39	11
HARM Missile (Navy)	766	205	-29	7
Standard Missile	1,150	600	-4	-15
Stinger Missile (Navy)	425	21	-38	-9

SOURCE: Compiled by Congressional Budget Office based on data supplied by supplied by the Department of Defense.

Vehicles. Funding for procurement of vehicles--primarily for the Army and Marine Corps--would fall by about 15 percent in real terms in 1988. This category buys all kinds of vehicles from trucks and other wheeled support vehicles to tanks and other tracked combat vehicles; consequently, it is not easily summarized. Focusing on major combat vehicles, about 550 fewer vehicles would be purchased in 1988 than in 1987. These reductions are accompanied by dissimilar changes in unit costs--the number of M-1 tanks purchased would decline by 25 percent but unit costs would rise 8 percent; numbers of Bradley fighting vehicles would decline 7 percent but unit costs would fall by 14 percent; yet a 50 percent cut in the quantity of a support vehicle for field artillery ammunition produces no change in unit costs.

Weapons Modifications. The budget for weapons modification would decline by 37 percent in real terms in 1988. Modifications of major weapons result in improvements ranging from small programs aimed at the reliability or maintainability of parts of a weapon to large-scale programs that add new capabilities to existing weapons or extend their useful lives. The real decline in the 1988 request is caused by reductions in aircraft modifications, the larger of which include the HH-53 helicopter and C-135 and B-52 aircraft in the Air Force and A-6, F-14, and S-3 aircraft in the Navy.

Ammunition. Ammunition procurement, like spare parts procurement, is sometimes considered to be a readiness activity. The 1988 request would decrease servicewide ammunition procurement by 16 percent from the 1987 level, although the Administration plans to increase the Army ammunition account, which includes $60 million for chemical weapons. The programs of the other services would decline in nominal terms, but retain $60 million for the Air Force and $10 million for the Navy for the BIGEYE bomb--a chemical weapon.

Ballistic Missiles. Procurement of ballistic missiles in 1988 would total $3.6 billion--one of the smallest amounts shown in Table IV-7--for a 38 percent, or $1 billion increase in real terms. The increase is attributable to the Trident II program; this submarine-launched ballistic missile would receive $2.3 billion in funding for 66 missiles--45 more missiles and $900 million more dollars than in 1987--and unit costs would decline by 49 percent. The Administration also proposes buying 21 MX-missiles for $1.3 billion--a 75 percent increase in quantity from 1987 levels, accompanied by a 36 percent decline in unit costs. These reductions in unit costs are probably the result of spreading fixed costs over a greater number of weapons, plus achieving efficiencies from more experience with production.

Research, Development, Test, and Evaluation

RDT&E funding is usually the first commitment to a weapons acquisition program, and it continues through the early stages of production. The Administration is seeking funds to continue the increases in RDT&E funding that have averaged 10 percent annually in real terms since 1980. The 1988 RDT&E budget of nearly $44 billion represents an increase in budget authority of $5.9 billion, or 17 percent (both in real terms), over 1987 levels.

Nearly all activities in the RDT&E account would experience real growth as shown in Table IV-10. The technology base, in which basic research is conducted in areas involving physical, mathematical, environmental, engineering, biomedical, and behavioral sciences, would receive about a 2 percent increase. Advanced technology development would grow about 40 percent, largely because of a proposed $5.2 billion request (a $2 billion increase over 1987) in the Strategic Defense Initiative (SDI). Whereas programs like SDI explore emerging technologies that have potential applications for defense, the request for RDT&E calls for a 18 percent real increase in strategic programs that have already passed these early develop-

TABLE IV-10. REAL CHANGES IN RESEARCH, DEVELOPMENT, TEST, AND EVALUATION (By fiscal year, in billions of dollars of budget authority and percent)

Activity	1988 Request (Dollars)	Real Changes 1986-87 (Percent)	1987-1988 Percent	1987-1988 Dollars	1988-89 (Percent)
Technology Base	3.4	-4	2	0.1	3
Advanced Technology Development	7.2	17	40	2.1	14
Strategic Programs	10.0	4	18	1.5	-11
Tactical Programs	13.7	4	20	2.3	-3
Intelligence and Communications	5.3	5	3	0.1	-12
Defense-wide Mission Support	4.2	-3	-3	-0.1	-3
Total	43.7	4	17	5.9	-3

SOURCE: Compiled by Congressional Budget Office based on data supplied by the Department of Defense.

mental stages. The increase in strategic programs reflects a $2.2 billion commitment to research on a small ICBM--the so-called Midgetman--and nearly $0.6 billion for research on a new railroad car basing mode for another 50 MX Missiles. In addition, the budget would provide $0.4 billion to extend the B-1B flight test program and $0.4 billion for the antisatellite program (Space Defense System).

The 20 percent increase in tactical programs for 1988 results from a number of programs, the larger of which include the Air Force's C-17 cargo aircraft ($1.2 billion), the Advanced Tactical Fighter ($0.5 billion), and the Army's LHX light helicopter ($0.4 billion). The planned increase of 3 percent in intelligence and communications would be offset by a 3 percent decline in defense-wide programs (that is, programs with many and diverse applications).

Other Accounts

Military construction and family housing funds support both weapons and personnel programs. The Administration's request for military construction would fund many projects within the United States and overseas, including the Strategic Defense Initiative (about $125 million), Navy Strategic Homeporting (about $280 million), and the Light Infantry Divisions (about $300 million) in New York and Alaska. The family housing program provides living accommodations for service members and their families, particularly in areas where private housing is scarce. The increase in funding for family housing would allow the building of 6,041 units in 1988 and 6,198 in 1989. The 1987 budget called for 5,349 units to be constructed.

The Department of Energy (DOE) conducts research and production programs for nuclear weapons and materials. DOE also administers programs for storing nuclear waste and for designing nuclear reactors for naval vessels. The Administration has requested a real increase of about $400 million, or 4 percent, over the 1987 budget for these programs. The largest real percentage increases are for nuclear safeguards and waste management--20 percent and 16 percent, respectively.

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CHAPTER V

THE ADMINISTRATION'S NONDEFENSE BUDGET

The President's proposals would result in nondefense outlays of $742 billion in 1988, an increase of less than 2 percent over the 1987 level and about 5 percent, or $39 billion, below the CBO baseline. Over the subsequent four years, growth in nondefense spending would average less than 4 percent per year, compared with over 5 percent in the baseline. Total reductions in nondefense spending over the 1988-1992 period would be $335 billion relative to the CBO baseline.

Human Resources Programs

Spending for human resources programs will account for over two-thirds of nondefense outlays in 1987. Under the President's proposals, outlays for such programs would continue to grow steadily over the 1987-1992 period, by an average of 5.6 percent a year. Under CBO baseline assumptions, however, they would grow by over 7 percent per year. The resulting savings relative to the baseline would total $167 billion from 1988 through 1992, a reduction of about 5 percent. (The dollar savings for each function are summarized in Table V-1; the percentage reductions are shown by function in Table V-2.)

Medicare (570) is targeted for the largest dollar reductions in any nondefense program, accounting for one-sixth of all proposed reductions in nondefense spending. As in previous years, the President proposes to increase premiums and deductibles and to reduce payments to hospitals and physicians. This year the Administration also plans to slow the payment of bills, resulting in 1988 savings of $2 billion. Total five-year Medicare savings would equal $53 billion, 10 percent of baseline spending.

Other federal spending on Health (550) would also be reduced sharply. Federal Medicaid spending would be capped below baseline levels in 1988 and allowed to grow only with increases in medical prices. Five-year Medicaid spending would be reduced almost $22 billion. The Administration also proposes to cap spending for the Public Health Service at 1987 levels, saving an estimated $11 billion over the projection period. Finally, the President would reduce federal spending for Federal Employees Health Benefits.

TABLE V-1. CBO ESTIMATES OF THE ADMINISTRATION'S PROPOSALS IN NONDEFENSE SPENDING (By fiscal year, in billions of dollars)

Budget Function	Increase or Decrease (-) in Outlays Relative to CBO Baseline		
	1988	1992	Total 1988-1992
Above Baseline Over Five Years			
International Affairs (150)	-0.2	0.5	2.4
General Science, Space, and Technology (250)	0.5	2.0	7.5
General Government (800)	0.9	0.7	4.9
Subtotal	1.2	3.2	14.8
Below Baseline Over Five Years			
Human Resources			
Education, Training, Employment, and Social Services (500)	-4.1	-11.7	-40.2
Health (550)	-3.3	-11.7	-37.8
Medicare (570)	-5.1	-17.2	-52.7
Income Security (600)	-4.2	-8.2	-31.6
Social Security (650)	-0.1	-0.5	-1.6
Veterans' Benefits and Services (700)	-0.7	-0.6	-3.3
Subtotal	-17.5	-49.9	-167.2
Natural Resources, Infrastructure, and Other Government Services			
Energy (270)	-2.1	-2.6	-13.1
Natural Resources and Environment (300)	-1.4	-4.0	-13.0
Agriculture (350)	-5.1	-9.5	-32.9
Commerce and Housing Credit (370)	-4.0	-6.0	-24.5
Transportation (400)	-1.7	-5.1	-18.7
Community and Regional Development (450)	-1.4	-2.6	-11.4
Administration of Justice (750)	0.1	-0.6	-2.0
General Purpose Fiscal Assistance (850)	-0.3	-0.5	-2.0
Subtotal	-15.9	-31.0	-117.5
Other			
Net Interest (900)	-1.5	-13.4	-34.9
Allowances (920)	-2.1	-3.4	-13.5
Undistributed Offsetting Receipts (950)	-3.2	-3.1	-16.2
Subtotal	-6.8	-19.9	-64.6
Total	-39.0	-97.6	-334.5

TABLE V-2. CBO ESTIMATES OF THE ADMINISTRATION'S PROPOSALS IN NONDEFENSE SPENDING (By fiscal year, in percent differences from the CBO baseline)

Budget Function	Percent Increase or Decrease (-) in Outlays Relative to Baseline		
	1988	1992	Total 1988-1992
Above Baseline Over Five Years			
International Affairs (150)	-1	3	3
General Science, Space, and Technology (250)	5	16	13
General Government (800)	13	10	14
Below Baseline Over Five Years			
Human Resources			
Education, Training, Employment, and Social Services (500)	-13	-30	-22
Health (550)	-7	-19	-15
Medicare (570)	-6	-13	-10
Income Security (600)	-3	-5	-4
Social Security (650)	a/	a/	a/
Veterans' Benefits and Services (700)	-3	-2	-2
Natural Resources, Infrastructure and Other Government Services			
Energy (270)	-39	-47	-48
Natural Resources and Environment (300)	-9	-21	-15
Agriculture (350)	-17	-45	-26
Commerce and Housing Credit (370)	-48	-222	-82
Transportation (400)	-6	-16	-12
Administration of Justice (750)	1	-6	-4
Community and Regional Development (450)	-21	-35	-33
General Purpose Fiscal Assistance (850)	-17	-22	-20
Other			
Net Interest (900)	-1	-9	-5
Allowances (920)	-228	-29	-45
Undistributed Offsetting Receipts (950) b/	8	6	7

a. Less than 0.5 percent.

b. Offsetting receipts rise, decreasing the deficit.

Altogether, Medicare and other federal health spending would be reduced $91 billion over the five years, accounting for over one-fourth of all proposed changes in nondefense spending.

The Administration also targets Education, Training, Employment, and Social Services (500) and Income Security (600) for large reductions-- $40 billion and $32 billion, respectively, over five years. The Administration proposes to limit the federal role in elementary and secondary education to programs targeted toward poor and disadvantaged children, saving $11 billion over the five years. In higher education, grant aid and federal loan subsidies would be reduced sharply. Students and their parents would be asked to pay the full interest and insurance costs of loans. Savings in federal higher education programs would exceed $22 billion. The President also proposes to sell college housing and facilities loans, which would save $1 billion relative to the CBO baseline. In income security programs, the President proposes to reduce housing assistance and to substitute vouchers for the more traditional forms of assistance, generating five-year savings of almost $9 billion. The Administration again proposes limiting cost-of-living adjustments in selected retirement and disability programs and limiting nutrition assistance only to low-income women and children. Five-year savings on retirement and nutrition programs would approach $14 billion.

Social Security (650) would receive the smallest reductions. No benefit cuts are requested, and only administrative costs would be reduced. While Social Security represents almost 30 percent of nondefense expenditures over the period, the requested Social Security reductions are less than 1 percent of nondefense savings. The President also proposes relatively modest reductions in Veterans' Benefits and Services (700). Veterans' medical care would be held below baseline levels, and the origination fee on Veterans Administration loans would be increased. Spending in this function would be reduced $3 billion, or 2 percent, below the baseline over the five years.

Natural Resources, Infrastructure, and Other Government Services

Spending on natural resources, infrastructure, and other government services currently account for less than one-fifth of nondefense outlays, or an estimated $129 billion in 1987. Under CBO baseline assumptions, spending for these programs and activities is expected to grow only slightly over the 1987-1992 period, with 1992 outlays only 5 percent above the 1987 level. This slow projected rate of increase occurs largely because increases in some areas would be offset by declining net outlays, under current law, for farm price supports and thrift insurance.

The President's budget proposals would reduce spending in these areas by an average of 15 percent below the baseline over the five-year period, with a net reduction in outlays of $103 billion. By 1992, spending under Administration policies would be about 17 percent below 1987 outlays, and almost 21 percent below the baseline.

The largest dollar savings from those policies--$5 billion in 1988 and $33 billion over five years--would be in Agriculture (350), with farm price support programs accounting for over $24 billion of that amount. The costs of farm programs have spiraled to record heights in 1986 and 1987, and the Administration is proposing to cut back by reducing target prices by 10 percent a year and by imposing other limitations and tighter eligibility requirements for payments. In addition, the Administration would make deficiency payments to farmers later than assumed in the baseline, instead of making advance deficiency payments as has usually been done in recent years. (This change accounts for most of the 1988 savings.) Farm operating and ownership loans from the Farmers Home Administration would be eliminated in 1989 and beyond, and subsidized crop insurance would be phased out. No funding is included in the budget for a possible bailout of the Farm Credit System. In total, agriculture spending would be reduced by 26 percent below the baseline over the 1988-1992 period.

Substantial reductions would also be made in Commerce and Housing Credit (370), with outlays declining by $25 billion over the five-year period relative to the CBO baseline. Sales of loan assets would produce net receipts of about $2 billion in 1988 and $4 billion over five years. In addition, the Administration would eliminate loans for low-income rural housing (to be replaced in part by housing vouchers), along with most direct lending for small business assistance and for construction of housing for the low-income elderly and handicapped. The Postal Service would have to raise postal rates in order to cover various costs that are now federally subsidized, and mortgage insurance fees charged by the Federal Housing Administration would be increased. Net outlays would be more than 80 percent below the baseline over the 1988-1992 period.

Proposed cuts in other functions, while not accounting for as much of a savings in dollars, represent sharp percentage reductions in net outlays. Energy (270) spending would be reduced by $13 billion, or 48 percent, over five years--$5 billion from the elimination of Rural Electrification Administration loans, $4 billion from loan sales and prepayments, and the remainder from eliminating conservation grants, slowing oil purchases for the Strategic Petroleum Reserve, and reducing energy research and development and other programs. Community and Regional Development (450) funding would

also be cut--by about one-third below baseline levels. Appropriations for Community Development Block Grants would be reduced, while Urban Development Action Grants and a variety of other grant and loan programs for both urban and rural areas would be terminated.

Other functions are targeted for smaller reductions. Spending for Natural Resources and Environment (300) programs would fall about 15 percent below the baseline over the 1988-1992 period. Funding for the construction of wastewater treatment facilities would be gradually reduced, and spending would be below the baseline for most programs for development of water and recreational resources; conservation; toxic waste cleanup; and oceanic, atmospheric, and fisheries research. Transportation (400) spending would also be reduced, by an average of 12 percent below the baseline over five years, saving almost $19 billion. The Administration would sharply reduce mass transit grants, constrain highway spending, eliminate Amtrak subsidies, and impose Coast Guard user fees. On the other hand, funding to modernize and improve the air traffic control system would be above baseline levels. Outlays for General Purpose Fiscal Assistance (850) would be about 20 percent, or $2 billion, below the baseline, primarily reflecting the Administration's cost-sharing proposals that would result in reduced payments to states from timber and mineral receipts. Administration of Justice (750) spending would be only 4 percent below the baseline over the 1988-1992 period, because the elimination of funding for the Legal Services Corporation and for certain justice assistance grants, along with reduced funding for the Customs Service, would be partially offset by increases for the courts, prisons, and general legal activities.

The President's request for funding in functions 150, 250, and 800 is above five-year baseline levels, as was the case in the 1987 budget request. General Government (800) spending would be about $5 billion, or 14 percent, above the baseline over the 1988-1992 period--largely because of increased expenditures for tax collection efforts of the Internal Revenue Service, and because of added spending to acquire and maintain federal buildings. Outlays for General Science, Space, and Technology (250) would be $8 billion, or 13 percent, above the baseline, reflecting proposed spending for a space station and for increasing basic research grants of the National Science Foundation. Expenditures for International Affairs (150) would be about $2 billion, or 3 percent, above the baseline. Increases for foreign military sales financing, military assistance grants, State Department operations, and contributions to multilateral development banks would be partially offset by reduced funding for a number of other activities and additional sales of Eximbank assets.

Other Nondefense Spending

The President's proposals for allowances, undistributed offsetting receipts, and net interest would result in net outlay reductions of $65 billion, relative to the baseline, over five years. Savings in Allowances (920) would be obtained primarily by constraining federal pay raises relative to the CBO baseline assumptions. Allowances also include the estimated budgetary impact of the Administration's credit reform initiative, which would increase outlays over five years by $5 billion. In total, outlays would be reduced by about $14 billion over the 1988-1992 period. The Administration would derive an estimated $16 billion in additional receipts, shown in Undistributed Offsetting Receipts (950), by selling the power marketing administrations, the Naval Petroleum Reserves, and licenses for the use of certain unassigned radio frequencies. These receipts would be partially offset by the loss of future income that would have been generated by the assets, estimated to be about $3 billion over the first five years and reflected in function 270. Finally, Net Interest (900) spending would be reduced by $35 billion over the five years, primarily because of the reduced deficits estimated for the President's policies.

The President's proposals for nondefense spending are discussed in more detail, by budget function, on the following pages.

FUNCTION 150: INTERNATIONAL AFFAIRS

MAJOR SPENDING CHANGES PROPOSED FOR BUDGET FUNCTION 150: INTERNATIONAL AFFAIRS (By fiscal year, in billions of dollars)

Item	1988	1989	1990	1991	1992	Cumulative Five-Year Changes
CBO Baseline	16.8	16.3	16.5	15.6	16.4	
Proposed Changes						
Sales of Financial Assets (Eximbank)	-0.8	-0.2	0.1	0.3	0.5	-0.1
Programmatic Changes						
Foreign military sales						
MAP grants	0.2	0.4	0.4	0.3	0.3	1.6
FMS credits	0.1	-0.0	-0.0	-0.1	-0.2	-0.2
State Department	0.2	0.4	0.3	0.3	0.3	1.5
Multilateral development banks	0.1	0.2	0.2	0.2	0.2	1.1
Other	-0.0	-0.1	-0.2	-0.5	-0.7	-1.5
Total	0.6	0.9	0.7	0.4	-0.1	2.5
President's 1988 Budget as Estimated by CBO	16.6	17.0	17.3	16.3	16.8	
President's 1988 Budget	15.2	18.1	17.9	18.0	17.7	
CBO Reestimates	1.4	-1.1	-0.6	-1.7	-0.9	-3.0

Proposed Policy Changes

The President's proposals for spending in the international affairs function are above CBO's baseline levels in all years except 1992, with increases totaling $2.5 billion, or 3 percent, over the 1988-1992 period. The growth is concentrated in foreign military sales financing and military assistance grants, State Department administrative expenses and contributions to

international organizations, and contributions to the multilateral development banks. These programmatic increases are partially offset by proposals for additional sales of assets by the Eximbank, particularly in 1988. Proposed spending for most other programs within the function is lower than the baseline levels because the Administration proposes annual growth at increases equal to half the expected inflation rate.

Export-Import Bank. The Administration is proposing to sell Eximbank loan assets with a face value of $1.2 billion in fiscal year 1988 and $1.0 billion per year in years 1989 through 1992 without recourse to the federal government. While the sale of assets will lower the deficits in fiscal years 1988 and 1989, the deficits in future years will increase from the forgone collections from the assets sold. The net five-year budgetary impact of the asset sales would be to lower the deficit by only $0.1 billion. The Administration is requesting an appropriation of $200 million for Eximbank in fiscal year 1988 for the grant element of tied-aid credits (credits with a subsidy greater than 25 percent of the loan amount) and $1 billion in direct loan authority. Direct loan authority drops to $0.9 billion per year in fiscal years 1989 through 1992, lowering outlays to $0.1 billion below baseline over the five-year period.

Foreign Military Sales. Foreign military sales financing includes foreign military sales (FMS) credits and military assistance grants--financing for foreign countries to buy U.S. military equipment. The budget proposes $1.3 billion in budget authority for military assistance grants in 1988--a 43 percent increase over 1987. This increase reflects a growing use of grants in FMS financing. For the five years 1988 through 1992, outlays would rise $1.6 billion above the CBO baseline. Also, although the President is requesting increases in FMS credits in 1988, funding for these credits would decline relative to the baseline because requested credits would rise by only half the inflation rate.

State Department. Proposed spending for the State Department is above the CBO baseline by $0.2 billion in fiscal year 1988 and $1.5 billion over the next five years. The increases are for salaries and expenses, the acquisition and maintenance of buildings abroad, and contributions to international organizations. Approximately $0.5 billion of the increase is for the embassy security program, while another $0.2 billion is for assessed contributions to international organizations. The rest is for updating information and computer systems, additional construction projects, wages, benefits, and expenses.

Multilateral Development Banks. Congress has sharply reduced subscriptions and contributions to the multilateral development banks in the last

several years. These reductions are reflected in the CBO baseline because it projects appropriations to increase over 1987 levels only at the rate of inflation. In the 1988 budget, the Administration seeks to recover all arrearages--cuts in previously requested funding levels--in fiscal year 1987 supplementals and higher appropriations for fiscal year 1988. In addition, the Administration is requesting funds to meet existing commitments for an eighth replenishment to the International Development Association and is subscribing to a new institution that promotes investment in developing countries--the World Bank's Multilateral Investment Guarantee Agency. These proposals will increase outlays by $1.1 billion above the baseline over the next five years.

Other. The President is requesting lower funding levels for voluntary contributions to international organizations, restructuring bilateral development assistance to Africa, and growth in the foreign information and exchange activities. Outlays for other programs overall are lower than the baseline by $1.5 billion over the next five years.

CBO Reestimates

Foreign Military Sales Debt Restructuring. The Administration is offering countries with FMS loans from the Federal Financing Bank (FFB) the option of prepaying their loans without a penalty or deferring part of the current interest due on their loans and making a lump-sum payment at the end of the loan repayment period. The Administration expects the prepayment option to reduce outlays in the international affairs function by $1.7 billion in fiscal year 1988 and raise outlays in fiscal years 1989 through 1992 by $1.1 billion. In addition, the deferred interest option is estimated in the budget to raise outlays in function 900 (net interest) by $2.0 billion in fiscal years 1988 through 1992. Because few debtor countries are expected to take advantage of the proposal, however, the CBO estimates no budgetary effect for the two options. Overall, CBO expects outlays will be $1.3 billion higher in 1988, but $0.7 billion lower in the 1989-1992 period than the Administration estimates.

Guarantee Reserve Fund. CBO estimates that outlays for the Guarantee Reserve Fund (GRF) will be $0.5 billion higher in 1988, but $0.2 billion lower over the 1988-1992 period than the Administration's estimate. The higher outlays for the GRF are entirely offset by higher collections by the FFB in function 900. The GRF covers late payments and rescheduled guaranteed FMS loans financed by the FFB. The Administration is proposing no replenishment of the GRF, even though the fund is exhausted; the GRF became insolvent in December 1986 with an account payable of $23 million.

The FFB held $18.8 billion in outstanding FMS loans at the start of fiscal year 1987. These loans bear interest rates fixed at the high cost of Treasury borrowing in the early 1980s, with repayment periods extending through the year 2014.

The President's budget assumes that Egypt will seek to defer its $0.5 billion in interest due in fiscal years 1987 through 1990. The cost of the rescheduling is included in the President's estimate of interest received by the FFB. The CBO baseline and reestimate of the President's request includes the anticipated rescheduling and other late payments as outlays from the GRF requiring appropriation rather than as forgone collections of the FFB.

Foreign Military Sales. Public Law 99-591, Making Continuing Appropriations for Fiscal Year 1987, requires disbursements of Military Assistance Program (MAP) grants and FMS credits to be held to a minimum necessary to meet timely payments on defense goods and services. This requirement and administrative changes dealing with special billings for countries receiving both MAP grants and FMS credits are expected to slow disbursements from appropriated accounts and raise net outlays from the FMS trust fund. For countries receiving both types of aid, the CBO reestimate of the President's budget assumes that MAP grants will be disbursed before new FMS credits, so as to raise MAP outlays. This increase, however, is more than offset by CBO's lower estimate of total outlays for foreign military sales credits as a result of estimated lower sales of military goods and services. On balance, CBO estimates are $0.3 billion lower in 1988 and $1.1 billion lower over five years than the Administration's.

Economic Support Fund. The President's estimate assumes all obligated balances of cash programs and all new cash programs will disburse at 100 percent for 1988-1992. Given that $300 million from cash programs was carried into fiscal year 1987, this assumption appears to be optimistic. The CBO reestimate uses slower outlay rates, yielding an estimate for 1988 that is $0.4 billion lower than the Administration's and $1.1 billion lower for the 1988-1992 period.

Exchange Stabilization Fund. Outlays from the Exchange Stabilization Fund (ESF) include gains and losses from exchange transactions and interest income from investments held by the fund, including investments in U.S. government securities. The President's budget outlay estimate for the ESF includes interest on investments in U.S. securities only. The CBO estimate includes interest income on all investments. Neither the CBO nor the Administration estimates outlays based on gains and losses resulting from

exchange transactions. The CBO reestimate is $0.2 billion lower in 1988 and $1.3 billion lower for 1988 through 1992.

Credit Programs

Direct Loans. The President is requesting increases over baseline direct loan authority in fiscal year 1988 for foreign military sales credits and Eximbank direct loans. The projected levels for years 1989 through 1992, however, do not keep pace with expected inflation and fall below CBO's baseline by $1.0 billion over the next five years.

Guaranteed Loans. The President's request for guarantee authority for the Overseas Private Investment Corporation (OPIC) and the Agency for International Development's Housing Investment Guarantee programs is below the baseline. Similarly, the President's request for Eximbank guarantees and insurance is lower than the 1987 limitation. Eximbank has not used all of its guarantee authority in recent years, and the lower limitation is not estimated to constrain its activity.

MAJOR CREDIT PROGRAM CHANGES PROPOSED FOR FUNCTION 150: INTERNATIONAL AFFAIRS (By fiscal year, in billions of dollars)

Item	1988	1989	1990	1991	1992	Cumulative Five-Year Changes
Direct Loan Obligations						
CBO Baseline	7.3	7.6	7.9	8.2	8.5	
Proposed Changes						
FMS Credits	0.2	0.1	0.0	-0.1	-0.2	0.1
Public Law 480	-0.1	-0.1	-0.1	-0.1	-0.2	-0.6
Eximbank	0.1	-0.1	-0.1	-0.2	-0.2	-0.5
Total	0.2	0.0	-0.2	-0.4	-0.6	-1.0
President's 1988 Budget as Estimated by CBO	7.5	7.6	7.7	7.8	7.9	
Guaranteed Loan Commitments						
CBO Baseline	9.2	9.5	9.9	10.4	10.4	
Proposed Changes						
OPIC	-0.1	-0.1	-0.1	-0.1	-0.1	-0.4
AID Housing Guarantees	-0.1	-0.1	-0.1	-0.1	-0.1	-0.3
Total	-0.1	-0.1	-0.1	-0.2	-0.2	-0.7
President's 1988 Budget as Estimated by CBO	9.1	9.4	9.8	10.2	10.3	

FUNCTION 250: GENERAL SCIENCE, SPACE, AND TECHNOLOGY

MAJOR SPENDING CHANGES PROPOSED FOR BUDGET FUNCTION 250: GENERAL SCIENCE, SPACE, AND TECHNOLOGY
(By fiscal year, outlays in billions of dollars)

Item	1988	1989	1990	1991	1992	Cumulative Five-Year Changes
CBO Baseline	10.7	11.5	11.9	12.2	12.4	
Proposed Changes						
National Science Foundation	0.1	0.3	0.4	0.7	1.0	2.4
Department of Energy (General science)	0.1	0.1	0.1	0.2	0.2	0.7
National Aeronautics and Space Administration	0.4	0.9	1.2	1.1	0.8	4.4
Total	0.5	1.3	1.8	1.9	2.0	7.5
President's 1988 Budget as Estimated by CBO	11.2	12.8	13.7	14.1	14.4	
President's 1988 Budget	11.4	13.2	13.5	13.8	14.3	
CBO Reestimates	-0.3	-0.4	0.2	0.3	0.1	-0.1

Proposed Policy Changes

The President proposes spending above baseline levels in all years for both basic research programs and National Aeronautics and Space Administration (NASA) activities in this function. The major increases relative to the CBO baseline are for NASA and the National Science Foundation (NSF).

Under the President's proposals, NASA outlays over the 1988-1992 period are estimated to be about $4.4 billion greater than under CBO base-

line assumptions, an increase of about 7 percent. Most of this increase is attributable to the proposed space station, which the Administration is seeking to have in operation by the mid-1990s. Funding in the budget for the space station grows rapidly--from $420 million in fiscal year 1987, to $767 million in 1988, and to around $2 billion annually beginning in fiscal year 1990. The CBO baseline assumes funding for the space station at the 1987 level, adjusted for inflation. The President's budget also contains decreased funding for space flight through fiscal year 1990, with increases thereafter. These levels assume the resumption of space shuttle launches beginning in 1988 and no new funding for orbiter construction. Construction of the Challenger replacement was fully funded in fiscal year 1987.

The President has also proposed a major increase in NSF funding relative to the CBO baseline, approximately doubling the fiscal year 1987 funding level by fiscal year 1992. NSF outlays over this period would be about 25 percent above baseline levels. Most of this increase is for research grants, with a large increase for science and engineering education activities as well.

Finally, the President is proposing funding increases of between $100 million and $200 million above baseline levels for the general science and research activities of the Department of Energy (DOE). Over the projection period, these increases would result in outlays about 18 percent above the baseline. Included in the request for fiscal year 1988 is $35 million for the design of the superconducting super collider (SSC), a particle accelerator of unprecedented size and power. The total cost of the SSC is estimated at between $5 billion and $6 billion over an eight-year period. No construction funds are included in the President's budget request.

CBO Reestimates

CBO reestimates result primarily from differences in projected spending rates for shuttle orbiter construction and space transportation operations throughout the projection period.

FUNCTION 270: ENERGY

MAJOR SPENDING CHANGES PROPOSED FOR BUDGET FUNCTION 270: ENERGY (By fiscal year, outlays in billions of dollars)

Item	1988	1989	1990	1991	1992	Cumulative Five-Year Changes
CBO Baseline	5.4	5.3	5.5	5.5	5.6	
Proposed Changes						
Rural electrification	-1.2	-1.6	-1.9	-2.2	-2.5	-9.4
Energy R&D	-0.2	-0.4	-0.5	-0.6	-0.7	-2.4
Conservation	-0.1	-0.3	-0.3	-0.3	-0.3	-1.4
Strategic Petroleum Reserve	-0.2	-0.3	-0.3	-0.3	-0.3	-1.3
Nuclear waste disposal	-0.1	-0.2	-0.3	-0.2	-0.2	-0.9
Naval Petroleum Reserves a/	b/	0.5	0.5	0.5	0.5	2.0
Power marketing administrations a/	b/	-0.2	-0.1	0.3	0.9	0.9
Other	-0.2	-0.3	b/	b/	b/	-0.5
Total	-2.1	-2.7	-2.8	-2.9	-2.6	-13.1
President's 1988 Budget as Estimated by CBO	3.3	2.6	2.7	2.6	3.0	
President's 1988 Budget	3.3	2.9	3.2	2.9	3.1	
CBO Reestimates	b/	-0.3	-0.5	-0.3	-0.2	-1.3

a. The receipts from the proposed sale of the Naval Petroleum Reserves and the power marketing administrations are shown in function 950. Outlays in function 270 would increase, relative to the baseline, after the proposed asset sales, because these assets would no longer generate receipts for the government.

b. Less than $50 million.

Proposed Policy Changes

The President is proposing substantial cuts in energy programs, which would reduce outlays by 39 percent below the baseline in 1988. Outlay savings would total $13.1 billion over the 1988-1992 period, or almost one-half of projected baseline spending for the five years. These savings are net of losses in receipts that would result from the proposed sale of the power marketing administrations (PMAs) and the Naval Petroleum Reserves (NPR). Excluding the effects of these sales on this function, outlay savings would total about $16.5 billion from 1988 through 1992.

Rural Electrification. By far the largest savings in this function would occur in activities of the Rural Electrification Administration (REA). The President would increase the interest rate on most of REA's direct loans from 5 percent to the Treasury's cost of borrowing plus one-eighth of a percent. The loan program would then be phased out by 1990. No commitments for new REA-guaranteed loans from the Federal Financing Bank would be made after 1987, and borrowers would be charged a fee to cover the cost of REA salaries and expenses. The President also plans to sell a portion of REA's direct loan portfolio, and to allow further prepayments of existing loans without assessment of penalties required under current law.

Eliminating loans from the rural electrification and telephone revolving fund, as proposed by the President, would lower outlays by approximately $4.8 billion over the next five years. Proposed additional prepayments of existing loans and sales of direct loans would reduce outlays by $4.3 billion through 1992. New fees and higher interest rates would save an additional $0.4 billion over this period. Estimated savings for the President's REA proposals total about $9.4 billion over the 1988-1992 period.

Energy Research and Development. Under the President's proposed budget, federal efforts in energy research and development for fossil, solar, and other energy technologies would be reduced by about $2.4 billion, or 17 percent, below baseline levels over the 1988-1992 period. The Administration believes that the government's role in energy research and development should be limited to basic research and long-term or high-risk projects.

Conservation. Conservation spending in the budget is $1.4 billion, or 67 percent, below baseline levels over five years. About $0.9 billion of this reduction results from the proposed elimination of grants to states for energy conservation programs, while the remaining $0.5 billion reduction applies to conservation research and development activities. The budget proposal asserts that states are expected to receive significant funds for

conservation as a result of the settlement of federal cases involving the alleged violation of oil price controls. In the past two years, nearly $3 billion in oil price overcharges has been disbursed to the states. Additional funds may be distributed to the states as pending overcharge cases are resolved.

Strategic Petroleum Reserve. The President proposes to reduce the rate of fill for the Strategic Petroleum Reserve (SPR), from the current rate of 75,000 barrels per day to 35,000 barrels per day. The reserve currently contains about 515 million barrels. The Energy Policy and Conservation Act (Public Law 94-163), as amended, authorizes a reserve of up to 1 billion barrels, and establishes a minimum fill rate of 75,000 barrels a day until the reserve contains at least 750 million barrels. At the current fill rate, the reserve will contain approximately 670 million barrels at the end of 1992 and would reach 750 million barrels in 1995. By comparison, the President's proposal would result in a total reserve of about 600 million barrels at the end of 1992 and of 750 million barrels in 2004. The President also proposes small decreases from current policy for development of SPR facilities. Reducing the fill rate accounts for most of the five-year outlay savings, estimated at $1.3 billion.

Nuclear Waste Disposal. The President's request for disposal of nuclear waste is $0.5 billion a year, resulting in a savings of about $0.9 billion over the five-year period relative to the CBO baseline. The baseline includes amounts that CBO estimates will be needed each year to comply with the Nuclear Waste Policy Act of 1982. This slowdown in developing a repository for nuclear waste reflects a lack of consensus on the future scope and direction of the program. The Administration has prepared a revised mission plan for the nuclear waste program, and plans to amend the 1988 budget request for additional funds if this plan is found to be acceptable.

Naval Petroleum Reserves and Power Marketing Administrations. Income from the sale of the five power marketing administrations and Naval Petroleum Reserves appears in budget function 950 and is estimated to total $15.5 billion over the 1988-1992 period. These savings would be partially offset, however, by an increase in outlays in function 270, because these assets would no longer generate receipts for the government. In 1992, when all the proposed sales would be completed, the outlay increase would be $1.4 billion relative to the baseline, and similar increases would occur in subsequent years. Over the five-year period, net outlays in this function would increase relative to the baseline by $0.9 billion because of the sale of the PMAs, and by an additional $2 billion as a result of the sale of the Naval Petroleum Reserves.

Other. The President proposes to sell approximately $250 million in energy conservation loans made by the Tennessee Valley Authority (TVA). This sale would take place in 1989, yielding receipts of approximately $160 million. Relative to the baseline, outlays would increase by about $50 million per year for fiscal years 1990 through 1992 as a result of the loan sale.

Proposed cutbacks in uranium enrichment activities would reduce outlays by about $0.2 billion by 1992. These spending reductions in uranium enrichment would enable the program to make partial repayments to the Treasury for past federal investments. Reduced spending in other regulatory and administrative programs would lower outlays by a total of $0.4 billion over the next five years.

CBO Reestimates

CBO's estimates of net outlays for function 270 under the President's budget proposals are below the Administration's estimates by $1.3 billion over the 1988-1992 period. Based on experience in recent years, CBO estimates reflect lower REA loan disbursements than assumed in the Administration's figures. These reestimates are partially offset by lower estimates of receipts and somewhat higher estimates of operating expenses for TVA and uranium enrichment.

Credit Programs

The President proposes to phase out REA's direct and guaranteed loan programs by 1990, and to increase the interest rate on any future direct loans. Under this policy change, REA's direct loans, which currently bear interest at 5 percent, would be reduced by a total of about $4.5 billion over the next five years, relative to the CBO baseline. Eliminating Federal Financing Bank (FFB) loans guaranteed by the REA would reduce federal lending activity by a total of $5.2 billion by 1992. The President proposes to replace FFB loans with 70 percent REA guarantees of private-sector loans, totaling $6.1 billion over five years.

MAJOR SPENDING CHANGES PROPOSED FOR BUDGET FUNCTION 270: ENERGY (By fiscal year, in billions of dollars)

Item	1988	1989	1990	1991	1992	Cumulative Five-Year Changes
Direct Loan Obligations						
CBO Baseline	2.1	2.3	2.4	2.4	2.6	
Proposed Changes						
REA direct loans	-0.6	-0.8	-1.0	-1.0	-1.1	-4.5
FFB loans for rural electrification	-1.0	-1.0	-1.0	-1.1	-1.1	-5.2
Total	-1.6	-1.8	-2.0	-2.1	-2.2	-9.7
President's 1988 Budget as Estimated by CBO	0.6	0.5	0.4	0.3	0.4	
Guaranteed Loan Commitments						
CBO Baseline	a/	a/	a/	a/	a/	
Proposed Changes (Rural Electrification)	1.0	1.3	1.6	1.6	1.6	7.1
President's 1988 Budget as Estimated by CBO	1.0	1.3	1.6	1.6	1.6	

a. Less than $50 million.

FUNCTION 300: NATURAL RESOURCES AND ENVIRONMENT

MAJOR SPENDING CHANGES PROPOSED FOR BUDGET FUNCTION 300: NATURAL RESOURCES AND ENVIRONMENT
(By fiscal year, outlays in billions of dollars)

Item	1988	1989	1990	1991	1992	Cumulative Five-Year Changes
CBO Baseline	15.5	16.9	18.5	18.8	18.7	
Proposed Changes						
Water resources	-0.3	-0.1	-0.2	-0.5	-0.8	-1.9
Conservation and land management						
Forest Service	-0.3	-0.3	-0.4	-0.4	-0.5	-1.8
Other	-0.3	-0.2	-0.5	-0.5	-0.4	-1.8
Recreational resources	-0.3	-0.4	-0.5	-0.5	-0.6	-2.3
Pollution control and abatement						
Construction grants	a/	-0.1	-0.3	-0.4	-0.8	-1.7
Other	-0.2	-0.3	-0.5	-0.6	-0.6	-2.1
Other natural resources	-0.2	-0.2	-0.3	-0.4	-0.4	-1.4
Total	-1.4	-1.7	-2.6	-3.3	-4.0	-13.0
President's 1988 Budget as Estimated by CBO	14.1	15.3	15.9	15.5	14.8	
President's 1988 Budget	14.2	15.2	15.3	14.9	14.5	
CBO Reestimates	-0.2	0.1	0.5	0.6	0.3	1.3

a. Less than $50 million.

Proposed Policy Changes

The President's budget proposes spending levels for natural resources and the environment that are below the CBO baseline in all years, with total

outlay savings of about $13 billion over the 1988-1992 period. Outlay savings relative to the baseline in 1988 would be $1.4 billion, resulting largely from appropriation requests that are 12 percent below the baseline level.

Water Resources. For 1988, the President is seeking an increase in budget authority of 2 percent above the 1987 budget authority for development of water resources, a funding level about 4 percent below the baseline. By proposing these funding levels, selling loan assets, and rescinding funds for watershed programs of the Soil Conservation Service (SCS), total requested spending for water resources would fall below baseline levels in all years, with total outlay savings of about $1.9 billion over the 1988-1992 period.

The President proposes a 5 percent increase in outlays for the Army Corps of Engineers in 1988, with spending frozen at about 1988 levels through 1992. The budget includes funds to finance 13 new construction projects authorized in the recently enacted water resources bill (Public Law 99-662) and to continue work on over 100 other construction projects. The proposed Corps spending program would result in outlays of about $45 million below baseline levels in 1988 and about $750 million lower over the 1988-1992 period.

The President proposes to rescind $96 million in 1987 budget authority and unobligated balances for SCS watershed protection activities and to reduce 1988 budget authority for these programs by 67 percent below the 1987 appropriation. These cuts would result in outlay savings of $147 million from 1988 baseline levels. The budget also proposes to eliminate these programs by 1989, resulting in total savings of about $1 billion over the 1988-1992 period.

The Administration is also proposing to sell all completed loans made by the Bureau of Reclamation to local irrigation districts, an action that would yield proceeds of approximately $105 million in 1988.

Conservation and Land Management. Total 1988 outlays for conservation and land management activities in function 300 would increase by $740 million above 1987 levels, primarily as a result of shifting the conservation reserve from the Commodity Credit Corporation (in function 350) to the Agricultural Conservation and Stabilization Service (ASCS). Excluding this functional shift, the budget would result in a $650 million decrease in outlays for all other conservation and land management activities from 1987 to 1988. The President's 1988 appropriation request for discretionary programs, excluding the conservation reserve, is about $600 million, or 18 percent, below the current 1987 appropriations, and $800 million, or 22 percent, below the baseline level.

Under the President's budget, the conservation reserve would receive $1.4 billion in 1988, about $700 million more than in 1987. Since its creation in the Food Security Act of 1985, the reserve has been funded with CCC borrowing authority. Starting in 1988, the reserve would be funded through direct appropriations to the ASCS. The proposed funding level for this program is above baseline levels by about $170 million in 1988 and by about $800 million over the 1988-1992 period.

The President, however, proposes sharp reductions in funding for other conservation programs, including a rescission of $185 million in 1987 budget authority and termination, by 1989, of all other soil conservation activities of the SCS and the ASCS, except for technical assistance to support the conservation reserve. Eliminating these programs would save about $220 million in 1988 outlays relative to the CBO baseline. Savings over the 1988-1992 period would total $1.3 billion.

The President also proposes to reduce land conservation funding for the Bureau of Indian Affairs by approximately 65 percent, resulting in savings from the baseline of $95 million in 1988 and totaling $0.6 billion over the 1988-1992 period.

The budget also contains a 6 percent decrease from 1987 to 1988 for existing Forest Service programs, with funding frozen at about the 1988 level thereafter. The proposed funding for the Forest Service would save $255 million relative to the baseline in 1988 and $1.8 billion over the 1988-1992 period. The decreases reflect reductions in construction activities, in certain recreation activities, and in forest research funds, as well as the fact that the budget includes no specific allowance for firefighting funds after 1987.

Recreational Resources. The President's budget reflects net funding cuts in 1988 budget authority for recreational programs of about 25 percent below the CBO baseline. The requested reductions, plus the effects of proposed rescissions and new recreation user fees, would result in outlay savings of over $300 million in 1988. The budget would hold funding for most operating accounts essentially level over the next five years but would call for large cuts in spending for acquisition of recreational lands and construction of facilities. Land acquisition programs for the Forest Service, National Park Service (NPS), and the Fish and Wildlife Service would be cut by 89 percent below the baseline in 1988. Recreational construction by the Department of the Interior would face cuts of 67 percent below the baseline.

New recreation user fees to be collected by the Forest Service, the Army Corps of Engineers, and the NPS are also proposed and would result in

additional offsetting receipts of about $74 million in fiscal year 1988 and about $117 million per year after that. Outlay savings in recreational resources programs would total $2.3 billion over the 1988-1992 period.

Pollution Control and Abatement. The appropriations requested by the Administration in 1988 for environmental programs would be about 15 percent below the CBO baseline. Proposed funding for the following four years falls below the baseline by an average of 21 percent. Resulting outlays, net of offsetting receipts, would be below baseline levels by about $170 million in 1988 and by $3.8 billion over the 1988-1992 period.

The largest savings would result from the Administration's proposal to phase out the Environmental Protection Agency's (EPA) construction grants program. This proposal would provide funding of $7.7 billion in declining amounts each year between fiscal years 1988 and 1992, or about $3 billion less than is authorized in the Water Quality Act of 1987 (Public Law 100-4), which was recently enacted over the President's veto. Outlay savings relative to the CBO baseline, which reflects the enacted authorization ceilings, would total about $1.7 billion over the five-year period.

The President's proposed funding levels for Superfund would reduce outlays below baseline estimates by about $850 million through 1992. The 1988 request would cut funding for EPA's abatement, control, and compliance programs by about 16 percent below the baseline and would freeze the funding level thereafter. Further, the Administration is seeking to rescind $47.5 million of the 1987 appropriation to assist in removing asbestos from schools. Resulting outlay savings for abatement, control, and compliance activities would total about $700 million through 1992.

Finally, the President seeks to impose user fees on the issuing of licenses and permits, and on other services provided by the EPA in its regulation of pollutants. Offsetting receipts would be increased by about $45 million annually.

Other Natural Resources. The President proposes to decrease spending on other natural resources by $1.4 billion relative to the CBO baseline from 1988 through 1992. The majority of these spending reductions come from the operations, research, and facilities of the National Oceanic and Atmospheric Administration (NOAA), which would be reduced by $0.9 billion over the five years.

The proposed spending for NOAA operations, research, and facilities is 14 percent below the CBO baseline over the 1988-1992 period. The budget would eliminate sea grants and coastal zone grants by rescinding their

budget authority for 1987, and would reduce total authority for ocean, atmospheric, and fisheries programs by more than 40 percent in 1988 relative to the 1987 level. Spending on satellite programs and the National Weather Service would increase in 1988, but not enough to offset the reductions in other programs. The Administration's proposal would reduce spending by the Bureau of Mines to a level that is 25 percent below the baseline over the five-year period. The budget also includes plans to sell all assets related to the Bureau's helium operations.

CBO Reestimates

The major estimating differences are attributable to Superfund spending and receipts. CBO estimates that Superfund outlays occur more rapidly than under the Administration assumptions. Also, CBO's estimates of funds recovered from private parties for cleanup costs are below the President's by approximately $600 million over the five-year budget period.

FUNCTION 350: AGRICULTURE

MAJOR SPENDING CHANGES PROPOSED FOR BUDGET FUNCTION 350: AGRICULTURE (By fiscal year, outlays in billions of dollars)

Item	1988	1989	1990	1991	1992	Cumulative Five-Year Changes
CBO Baseline	30.0	28.0	25.3	22.8	21.0	
Proposed Changes						
Commodity Credit Corporation	-4.6	-2.9	-4.1	-5.4	-7.2	-24.2
Agricultural Credit Insurance Fund	a/	-1.0	-1.0	-0.9	-0.8	-3.6
Federal Crop Insurance	-0.2	-0.3	-0.5	-0.6	-0.8	-2.4
Extension Service	-0.1	-0.1	-0.1	-0.1	-0.2	-0.6
Other	-0.3	-0.3	-0.4	-0.5	-0.6	-2.1
Total	-5.1	-4.7	-6.1	-7.6	-9.5	-32.9
President's 1988 Budget as Estimated by CBO	24.9	23.3	19.3	15.2	11.5	
President's 1988 Budget	26.3	21.8	18.2	14.7	13.0	
CBO Reestimates	-1.4	1.5	1.0	0.5	-1.5	0.1

a. Less than $50 million.

Proposed Policy Changes

The President's budget proposes spending reductions in the agriculture function by reducing direct income support and direct loans to farmers provided through the Commodity Credit Corporation (CCC) and the Farmers Home Administration (FmHA), phasing out the federal subsidy for crop insurance, reducing funding for agricultural research and services, and imposing new

user fees for some marketing and inspection activities. Total savings relative to the CBO baseline would be $32.9 billion over the 1988-1992 period.

Commodity Credit Corporation. The largest outlay savings from proposed policy changes would occur in the CCC. The 1988 savings result largely from the Administration's decision not to provide advance deficiency payments beginning with the 1988 crops. Such payments, which have been provided in recent years and were required by law for the 1987 crops, are assumed in the CBO baseline for all years. Under the President's proposed policies, advance deficiency payments, if made on the same basis as in 1987, would be $4.5 billion in 1988.

The President also proposes to reduce deficiency payments over time by lowering target prices 10 percent per year, which is faster than the reductions already mandated under current law. For example, the target price for corn, currently $3.03 per bushel for the 1987 crop, would decline to $2.21 for the 1990 crop under the Administration's proposal--compared with $2.75 for the 1990 crop under current law. Deficiency payments for all crops would decline from $12 billion for the 1986 crop year to $5 billion for the 1990 crop year under this proposal.

Other policy proposals include placing stricter limitations on total payments to any individual by reducing the current overall payment limitation from $250,000 to $50,000 per program participant and by tightening eligibility requirements for payments in an effort to reduce farm reorganizations prompted by the payment limitation. The President also proposes to remove the requirement that farmers plant program crops to receive deficiency payments. The budget includes a proposal to provide discretionary authority to the Secretary of Agriculture to increase the maximum allowable annual reductions in formula loan rates to 10 percent; under current law, the reduction is limited to 5 percent.

In addition, the President proposes to reduce the level of price supports for sugar while compensating domestic sugar producers for part of their lost revenue. This action would significantly benefit sugar users, but would increase CCC outlays by $1.7 billion over the 1988-1992 period. A final proposal would reduce the minimum annual levels for short-term export credit loan guarantees from $5 billion to $3 billion and would raise origination fees to 5 percent. The proposed changes in price support programs would reduce outlays by an estimated $24.2 billion over the 1988-1992 period. Under these policies, CCC outlays would total about $9 billion in 1992, compared with almost $26 billion in 1986.

Agricultural Credit Insurance Fund. The President also proposes to reduce spending for FmHA loan programs, with total estimated savings of $3.6 billion over five years. For 1988, the President would maintain direct loans to farmers provided through the Agricultural Credit Insurance Fund (ACIF) at levels similar to those in the CBO baseline, but would eliminate direct loans other than emergency disaster loans beginning in 1989. The Administration instead would provide increased amounts of loan guarantees for private loans.

Federal Crop Insurance. The President again proposes reducing the federal role in providing crop insurance by eliminating subsidies for premiums paid by farmers and for administrative expenses over a five-year period. This action would be accomplished through substantial increases in farmers' premiums, followed by privatization of crop insurance services. Estimated savings would total $2.4 billion over the 1988-1992 period.

Extension Service. Further savings would be obtained by reducing funding for the Extension Service from $332 million in 1987 to $263 million in 1988. All categorical grant programs, the largest of which is the Expanded Food and Nutrition Education Program, would be eliminated. Savings would total $580 million over the 1988-1992 period.

Other Agriculture Programs. The President's budget would also reduce spending for agricultural research. Although funding for the in-house research program would be increased, this increase would not offset the reduction in funds provided to state research institutions. The 1988 budget request of $778 million is nearly 14 percent below CBO baseline levels.

Other proposed spending reductions in the President's budget result from new and expanded user fees in marketing and inspection services, including grain inspection, activities focusing on plant and animal diseases and pest control, and services to agricultural cooperatives. In addition, no further funding is being requested for the Temporary Emergency Food Assistance Program.

Neither the President's budget nor the CBO baseline contains any provision for federal assistance to the Farm Credit System (FCS). Many agricultural and financial experts are projecting that such aid will be needed in the near future. Estimates of the government assistance required to prevent failure of the FCS range as high as $15 billion. Current law requires appropriation action before any such spending could take place.

CBO Reestimates

Most of the CBO outlay reestimate is for the Commodity Credit Corporation. For 1988, the Administration has assumed a $1.0 billion increase in outlays for working capital, which CBO has not included in its estimate. For 1989, CBO estimates that CCC outlays under the Administration's policies would be $1.8 billion higher than estimated in the budget. About $1.1 billion of the 1989 reestimate is caused by differences in the assumed timing of 1987 crop feed grain deficiency payments, while the remainder is caused by different assumptions concerning supply and use. Estimating differences in later years reflect differing estimates of savings from the proposed reductions in target prices.

The CBO outlay estimate for the Agricultural Credit Insurance Fund is below that of the President during the years 1989 through 1991 by an average of $300 million a year, because CBO projects lower obligations of emergency disaster loans than does the President. Beginning in 1989, the CBO estimate of costs for federal crop insurance exceeds the President's, because CBO projects a higher ratio of losses to premiums during this period.

Credit Programs

As indicated above, the President proposes reductions in export credit loan guarantees and in resulting direct loans made by the CCC. The President also seeks to eliminate direct loans for farm ownership beginning in 1988 and for farm operations beginning in 1989, while steadily increasing the limitations on ACIF loan guarantees over the five-year period.

MAJOR CREDIT PROGRAM CHANGES PROPOSED FOR FUNCTION 350: AGRICULTURE (By fiscal year, in billions of dollars)

Item	1988	1989	1990	1991	1992	Cumulative Five-Year Changes
Direct Loan Obligations						
CBO Baseline	17.5	16.2	15.1	14.3	13.8	
Proposed Changes						
Commodity Credit Corporation	a/	-0.8	-1.5	-2.1	-2.6	-7.1
Agricultural Credit Insurance Fund	-0.3	-1.1	-1.1	-1.1	-1.3	-4.9
Total	-0.3	-1.9	-2.6	-3.3	-3.9	-12.0
President's 1988 Budget as Estimated by CBO	17.2	14.4	12.5	11.1	9.9	
Guaranteed Loan Commitments						
CBO Baseline	8.5	9.1	9.3	9.4	9.6	
Proposed Changes						
Commodity Credit Corporation	-2.0	-2.0	-2.0	-2.0	-2.0	-10.0
Agricultural Credit Insurance Fund	-0.5	0.4	0.3	0.3	0.4	0.9
Total	-2.5	-1.6	-1.7	-1.7	-1.6	-9.1
President's 1988 Budget as Estimated by CBO	6.0	7.5	7.6	7.7	8.0	

a. Less than $50 million.

FUNCTION 370: COMMERCE AND HOUSING CREDIT

MAJOR SPENDING CHANGES PROPOSED FOR BUDGET FUNCTION 370: COMMERCE AND HOUSING CREDIT
(By fiscal year, outlays in billions of dollars)

Item	1988	1989	1990	1991	1992	Cumulative Five-Year Changes
CBO Baseline	8.3	5.8	7.5	5.6	2.7	
Proposed Changes						
FmHA's Rural Housing Insurance Fund	-2.1	-2.6	-3.1	-3.2	-3.6	-14.7
Housing for the elderly or handicapped	-0.5	a/	-0.2	-0.4	-0.5	-1.6
Federal Housing Administration	-0.5	-0.6	-0.6	-0.7	-0.8	-3.2
SBA business loans	-0.7	-0.5	0.1	a/	-0.1	-1.2
Postal Service	-0.1	-0.7	-0.8	-0.9	-1.0	-3.4
Federal Savings and Loan Insurance Corp.	-0.2	0	0	0	0	-0.2
Other	a/	a/	-0.1	-0.1	-0.2	-0.3
Total	-4.0	-4.4	-4.7	-5.3	-6.0	-24.5
President's 1988 Budget as Estimated by CBO	4.3	1.5	2.8	0.3	-3.3	
President's 1988 Budget	2.5	0.7	1.4	0.2	-1.6	
CBO Reestimates	1.8	0.8	1.3	0.1	-1.7	2.4

a. Less than $50 million.

Proposed Policy Changes

The Administration proposes terminating or reducing a number of programs that currently support commerce or housing activities. Proposed legislation

would also require agencies to increase user fees or sell assets to recover a greater portion of their costs. These changes would reduce spending by about $4 billion in 1988, and by $25 billion over the 1988-1992 period.

Rural Housing Programs. More than half of the outlay reductions in this function would involve the Rural Housing Insurance Fund of the Farmers Home Administration (FmHA). The President proposes to eliminate rural housing assistance programs for low-income borrowers for fiscal year 1988 and beyond. Most of this assistance is provided in the form of reduced interest rates for mortgage loans to low-income households or to developers of low-income rental housing. FmHA's current supplemental rental payments program would also be eliminated and replaced with housing vouchers that would pay part of the rental costs of low-income households. This new program would appear in budget function 600 (income security). The funding sought in the budget for vouchers would assist an estimated 20,000 households; by comparison, CBO estimates that baseline funding levels are sufficient to provide in each year about 28,700 homeownership loans and funding for about 21,200 rental units. The Administration also proposes to reduce fiscal year 1987 loan authority to about $0.5 billion from the appropriated level of over $2.0 billion. Including this reduction, the President's programmatic proposals would lower outlays by about $1.1 billion in 1988 and by a total of $11.5 billion for the years 1988-1992 relative to the CBO baseline.

The President's budget also proposes to sell to the public over the next five years a total of $5.2 billion in direct loans previously made by FmHA. Both the budget and CBO estimates assume that these financial assets would be sold without any recourse to the federal government. The sale of these loans would reduce federal outlays by $1.0 billion in 1988 and by an estimated $3.2 billion over the 1988-1992 period.

Housing for the Elderly or Handicapped. The Department of Housing and Urban Development (HUD) currently makes direct loans to nonprofit sponsors to finance construction of housing for low-income elderly or handicapped residents. For 1987, the Congress has appropriated $593 million in direct loan authority to finance the construction of about 12,000 units. The President would reduce 1987 funding to $502 million and would virtually eliminate the program in 1988 and beyond. The Administration's programmatic changes and reductions would reduce federal outlays, relative to the baseline, by about $60 million in 1988 but by more than $1.4 billion during the five-year projection period.

The Administration is also assuming that $500 million in housing loans to the elderly and handicapped will be sold in 1988. CBO estimates that

these loans are expected to bring in close to $420 million at sale; after deducting loan repayments forgone by HUD, however, the sale would reduce federal outlays by only about $210 million over the 1988-1992 period. The loans are expected to be sold without any recourse to the federal government.

Federal Housing Administration (FHA). At the time a mortgage loan guaranteed by the FHA is closed, the borrower pays a fee typically amounting to 3.8 percent of the loan amount. The President is proposing to increase this fee to about 5 percent in July 1987, with the actual increase to be determined by a study. Other proposed changes include restricting eligibility to primary residences only and requiring a minimum down payment of 5 percent for borrowers with annual incomes exceeding $40,000. Savings are estimated to total $3.2 billion over five years, largely from the increase in fees.

Small Business Administration (SBA). The Administration would end direct loans for small business assistance, but would provide $20 million for purchases of debentures issued by Minority Enterprise Small Business Investment Companies (MESBICs). (A total of $140 million has been provided for loan programs in 1987.) The Administration would continue to offer guarantees of privately originated loans, totaling $3.5 billion annually. However, the budget would increase fees for these loan guarantees and would require fees for technical assistance and other administrative purposes. Beginning in 1988, the President would also transfer to the SBA the activities of the Minority Business Development Agency in the Department of Commerce. The Administration would sell $1 billion of SBA's general business loans in 1988 and in 1989, as well as the entire portfolio of loans to small business development companies over the two-year period. Outlay savings relative to the baseline would be $0.7 billion in 1988 and $0.5 billion in 1989, with cumulative savings of $1.2 billion over the five-year period.

Postal Service. The President is proposing to increase Postal Service payments to the Civil Service Retirement fund to cover the actuarial costs of pensions for employees remaining in the old Civil Service Retirement System. Payments would increase over a five-year period from the current 7 percent of salary to 17 percent. Another proposal would require the Postal Service to begin paying the cost of premiums for postal annuitants' health benefits beginning in 1988. These two changes would increase the costs of the Postal Service by about $0.4 billion in 1988 and by $1.1 billion over the five-year period. (These payments, totaling almost $4.0 billion through 1992, are intragovernmental transactions and would be reflected as offsetting receipts in other functions.) To recover these costs, the Postal Service would increase postal rates, resulting in net savings to the federal government over time.

The President is again proposing to eliminate the subsidy for revenue forgone, except for the portion of the subsidy that covers free mail for the blind and for overseas absentee voters. This payment compensates the Postal Service for revenues lost as a result of reduced postage rates for certain classes of mailers--primarily religious and other nonprofit organizations, newspapers with a small circulation, and libraries. Rather than burden taxpayers with support for these subsidies, the President would eliminate eligibility for certain mailers and maintain the subsidy for the remaining groups by increasing rates for other classes of mail. These changes would reduce appropriations by $0.6 billion to $0.7 billion annually beginning in 1988.

Assuming enactment of these proposals, CBO estimates that the price of first-class postage would increase to 26 cents in the last quarter of 1988, or 1 cent more than assumed in the CBO baseline. Such an increase would generate an additional $6.7 billion in revenue relative to the baseline in the 1988-1992 period. The combination of proposals affecting the Postal Service would result in increased net savings in this function of $3.4 billion, and increased receipts in other budget functions of $4.0 billion, for a net spending reduction of about $7.4 billion relative to the baseline over the five-year period.

Federal Savings and Loan Insurance Corporation (FSLIC). The Administration is proposing legislation that would establish a government-sponsored financing corporation to borrow from the public and convey funds to the FSLIC. The corporation would finance its borrowing primarily by drawing off assessment income from the FSLIC. The additional funds would be used by the FSLIC to assist failing thrift institutions. CBO expects that the lag between commitments and disbursements of the new funding will result in reduced net outlays of about $150 million in 1988, relative to the baseline, and that there will be no significant effect on outlays over the remainder of the five-year period.

Other Advancement and Promotion of Commerce. The budget proposes increasing the 1988 program levels for the Securities and Exchange Commission (SEC) and the Commodity Futures Trading Commission--the former by 30 percent over the 1987 appropriation, and the latter by 10 percent--to strengthen their enforcement and market surveillance activities. The SEC's responsibility for regulating public utility holding companies would be eliminated, however, as proposed in last year's budget. The President also proposes to eliminate the Trade Adjustment Assistance program administered by the International Trade Administration, after rescinding $11 million of its 1987 funding. The budget also includes a user fee of $1 per ticket for international travel to and from the United States to fund the

United States Travel and Tourism Administration, partially in 1988 and fully in 1989 and beyond.

CBO Reestimates

Spending by the financial insurance funds--the FSLIC and the Federal Deposit Insurance Corporation (FDIC)--is very uncertain because of the precarious condition of many of their member institutions. CBO estimates that outlays for these two funds will be $1.8 billion less than the budget figures for 1987, but $1 billion to $2 billion higher in each of the years 1988 through 1990, because of differing expectations as to the cost and timing of actions involving the failure of banks and savings and loan institutions. Unlike the Administration, CBO expects that the proposed recapitalization of the FSLIC will have no significant net outlay effect over time, because offsetting collections from the financing corporation would be offset by disbursements for assisting troubled institutions.

CBO's estimates of Postal Service outlays are lower than the Administration's, especially in the 1989-1992 period, for several reasons: the Administration's figures do not incorporate postal rate increases to finance its proposals to increase Postal Service contributions to the retirement and health benefits funds; CBO estimates a slower rate of disbursement for capital investments; and the Administration's figures do not reflect the large year-to-year swings in net operating income that result from periodic rate increases. Over the 1988-1992 period, CBO's estimates of Postal Service outlays are about $6 billion below the Administration's.

The 1988 budget indicates that legislation will be proposed to prohibit the Postal Service from borrowing for capital purposes from the Federal Financing Bank (FFB). Because the Administration's budget estimates do not reflect the termination of this borrowing authority, however, CBO assumes that the Postal Service will continue to finance its capital program -- over $9.2 billion in the next five years--through the FFB.

CBO's outlay estimates for the Rural Housing Insurance Fund exceed those of the Administration by about $0.7 billion for 1988 and by a total of $1.4 billion for the 1988-1992 period. Most of these differences are attributable to the assumption by CBO that the FmHA will be required to pay an interest penalty when debt securities held by the FFB are redeemed early. These securities were sold to the FFB in prior years to help finance rural housing loans for low-income borrowers. The penalty payments would appear as outlays in function 370 but would be entirely offset by receipts in function 900.

Credit Programs

Consistent with the President's proposal to terminate or curtail a number of commerce and housing programs, direct and guaranteed loans would be reduced relative to the CBO baseline by about $14.6 billion and $173.2 billion, respectively, over the 1988-1992 period. Direct lending for small businesses, housing for the elderly and handicapped, and rural housing would be virtually eliminated. Changes in FHA's eligibility requirements and guarantee fees are estimated to reduce guaranteed loan commitments by about $171 billion over the five-year period.

MAJOR CREDIT PROGRAM CHANGES PROPOSED FOR FUNCTION 370: COMMERCE AND HOUSING CREDIT (By fiscal year, in billions of dollars)

Item	1988	1989	1990	1991	1992	Cumulative Five-Year Changes
Direct Loan Obligations						
CBO Baseline	4.1	4.4	4.5	4.7	4.9	
Proposed Changes						
Rural Housing Insurance Fund	-2.1	-2.2	-2.3	-2.4	-2.5	-11.6
Housing for elderly or handicapped	-0.5	-0.6	-0.7	-0.7	-0.7	-3.2
SBA business loans	-0.1	-0.1	-0.1	-0.1	-0.2	-0.7
Government National Mortgage Association	0.3	0.2	0.1	0.3	0.1	1.0
Other	a/	a/	a/	a/	a/	a/
Total	-2.4	-2.8	-3.0	-3.0	-3.4	-14.6
President's 1988 Budget as Estimated by CBO	1.7	1.6	1.5	1.7	1.5	
Guaranteed Loan Commitments						
CBO Baseline	91.8	94.1	99.2	103.9	107.1	
Proposed Changes						
Federal Housing Administration	-24.7	-33.2	-36.0	-38.0	-39.2	-171.1
SBA business loans	-0.1	-0.2	-0.4	-0.5	-0.7	-1.9
Other	a/	a/	a/	a/	a/	-0.1
Total	-24.9	-33.4	-36.5	-38.5	-39.9	-173.2
President's 1988 Budget as Estimated by CBO	66.9	60.7	62.7	65.3	67.3	

a. Less than $50 million.

FUNCTION 400: TRANSPORTATION

MAJOR SPENDING CHANGES PROPOSED FOR BUDGET FUNCTION 400: TRANSPORTATION (By fiscal year, outlays in billions of dollars)

Item	1988	1989	1990	1991	1992	Cumulative Five-Year Changes
CBO Baseline	28.8	29.4	30.1	30.9	31.6	
Proposed Changes						
Mass transit	-0.6	-1.3	-1.5	-2.0	-2.2	-7.4
Federal-aid Highways	-0.2	-0.7	-1.2	-1.5	-1.5	-5.1
Amtrak	-0.6	-0.6	-0.6	-0.7	-0.7	-3.3
Coast Guard user fees	-0.4	-0.5	-0.5	-0.5	-0.5	-2.3
Federal Ship Financing Fund	-0.1	-0.1	-0.1	-0.1	-0.1	-0.7
FAA operations, facilities, and equipment	0.3	0.4	0.4	0.4	0.4	1.9
Other	-0.2	-0.2	-0.6	-0.4	-0.5	-1.9
Total	-1.7	-3.0	-4.0	-4.8	-5.1	-18.7
President's 1988 Budget as Estimated by CBO	27.0	26.4	26.1	26.1	26.5	
President's 1988 Budget	25.5	26.7	26.4	25.8	26.2	
CBO Reestimates	1.5	-0.3	-0.3	0.3	0.3	1.4

Proposed Policy Changes

The Administration's proposal would reduce transportation spending below the CBO baseline in all years, with total savings of $18.7 billion over the 1988-1992 period. The budget includes a 16 percent cut ($4.8 billion) from the baseline in 1988 budget authority, with first-year outlay savings of $1.7 billion.

Ground Transportation. Reductions in spending for ground transportation, particularly mass transit, would account for most of the outlay savings in this function. The Administration proposes to limit budget authority and obligations for transit programs to $1.5 billion annually, compared with 1987 funding of $3.5 billion. All but $130 million (for the Washington, D.C., transit system) would be financed from the Highway Trust Fund by the 1 cent of the 9-cent-per-gallon gasoline tax that is currently earmarked for mass transit. The President is proposing to allocate grant funds to states and localities entirely by formula, providing capital assistance to all areas and operating assistance to small cities and rural areas only. Recipients would be required to make matching contributions of at least 50 percent. The Administration would also fund administration, planning, and research from the trust fund. Outlay savings in transit programs would total $7.4 billion over the 1988-1992 period.

The budget also includes reductions in the Federal-aid Highways program, reflecting the Administration's proposal to reauthorize highway programs that expired at the end of fiscal year 1986. The Administration would replace separate funding for interstate construction, interstate repair, and primary highways construction with a combined program funded at $8.2 billion annually. States would have discretion in allocating funds among the eligible uses. The budget would limit total annual budget authority and obligations from the highway account of the Highway Trust Fund to estimated average annual tax receipts into that account. Under this proposal, total budget authority for Federal-aid Highways would be only $13.4 billion per year in fiscal years 1987 through 1990, $14.4 billion in 1991, and $14.7 billion in 1992, compared with $14.6 billion in 1986. Obligations would be about the same as the proposed budget authority over this period, but would be much lower than the baseline obligation levels, which would reach $16.6 billion by 1992. Resulting outlay savings would be $5.1 billion over the 1988-1992 period.

As in previous years, the Administration proposes to eliminate all subsidies for Amtrak, reducing outlays over the five years by $3.3 billion. Elimination of these subsidies, together with the proposed sale of all or part of Amtrak's assets, could lead to a substantial reduction in intercity rail passenger service and the end of Amtrak in its current form.

Water Transportation. As in previous years, the 1988 budget includes a proposal to impose new user fees for various services performed by the Coast Guard. The new fees would result in net outlay reductions of $2.3 billion over the 1988-1992 period. Total proposed funding for the Coast Guard is close to the baseline over this period.

The President is requesting a fiscal year 1987 supplemental appropriation to cover the repayment of principal and interest from the Federal Ship Financing Fund to the general fund. This is an intragovernmental transaction that has no overall budgetary impact. It results in lower outlays in function 400--savings of $0.7 billion over five years--which would be exactly offset by lower receipts and increased outlays in function 900.

Air Transportation. The only area of transportation targeted for significant funding increases is aviation. The President proposes a major increase in spending for aviation programs in 1988, and would increase spending at close to the baseline rate of growth in subsequent years. Most of the increase in 1988 would be to modernize and improve the air traffic control system. Under the President's budget, spending authority for Federal Aviation Administration (FAA) facilities and equipment would be increased from $805 million in 1987 to $1.35 billion in 1988, and would average $1.4 billion a year over the 1989-1992 period. Spending for FAA operations would be above baseline levels between 1988 and 1990 before leveling off in 1991. The additional funds would be used to hire more air traffic controllers, safety inspectors, and aviation security personnel. The Administration proposes to derive approximately 75 percent of the funds for FAA operations from the Airport and Airway Trust Fund, compared with just under 25 percent in 1987.

CBO Reestimates

CBO estimates that spending under the Administration's policies would be $1.4 billion higher over the five-year period than estimated in the budget. Largely because CBO assumes that action on a highway reauthorization bill will be completed sooner than anticipated by the Administration, CBO's estimate of outlays for Federal-aid Highways in fiscal year 1988 is $1.0 billion higher than the Administration's. Other changes result from different spending rates, especially for mass transit programs.

The President's budget includes a proposal to sell all or part of the assets of Amtrak, with estimated receipts to the government of $1 billion. CBO is unable to estimate the effect of this proposal, because it is not yet clearly defined. Because of the complexity involved in disposing of Amtrak's assets, it may be difficult or impossible to obtain the receipts in fiscal year 1988. Furthermore, it is unclear how the federal government could generate substantial receipts from the disposal of assets while maintaining Amtrak operations, or whether such operations would be continued at all. Also, there is no apparent ready buyer for Amtrak's assets. Therefore, no savings are included in CBO's estimates. The Administration has included these receipts in function 950.

FUNCTION 450: COMMUNITY AND REGIONAL DEVELOPMENT

MAJOR SPENDING CHANGES PROPOSED FOR BUDGET FUNCTION 450: COMMUNITY AND REGIONAL DEVELOPMENT
(By fiscal year, outlays in billions of dollars)

Item	1988	1989	1990	1991	1992	Cumulative Five-Year Changes
CBO Baseline	6.6	6.7	7.1	7.2	7.5	
Proposed Changes						
Community Development Block Grants	-0.2	-0.4	-0.6	-0.7	-0.8	-2.6
Urban Development Action Grants	-0.1	-0.1	-0.2	-0.2	-0.2	-0.9
Other community development programs	-0.3	-0.3	-0.3	-0.3	-0.3	-1.6
Rural Development Insurance Fund	-0.1	-0.3	-0.8	-0.8	-0.6	-2.6
Other regional development programs	-0.5	-0.7	-0.7	-0.6	-0.6	-3.1
Disaster programs	-0.2	-0.2	-0.1	-0.1	a/	-0.6
Total	-1.4	-2.0	-2.7	-2.6	-2.6	-11.4
President's 1988 Budget as Estimated by CBO	5.2	4.7	4.4	4.6	4.8	
President's 1988 Budget	5.5	4.4	4.0	4.2	4.2	
CBO Reestimates	-0.3	0.3	0.4	0.4	0.6	1.4

a. Less than $50 million.

Proposed Policy Changes

As in previous budgets, the 1988 budget proposes major reductions in spending on community and regional development. Many of the programs within this function would be eliminated, while others are slated for large reductions. Total savings relative to the CBO baseline are estimated to be $11.4 billion over the 1988-1992 period, a reduction of about 32 percent in spending in this function. The President's proposals are based on the view that many of the benefits of these programs are local in nature, and that the costs therefore should be borne locally.

Community Development. About $5.1 billion of the five-year savings relative to the CBO baseline is in community development programs, which are aimed at urban areas. The budget includes reduced funding for Community Development Block Grants (CDBGs), beginning in fiscal year 1987 with a rescission of $375 million. (The 1987 appropriation is currently $3.0 billion; the program would continue at an annual level of $2.6 billion.) In addition, the President would terminate the Urban Development Action Grant (UDAG) program, beginning with a $238 million rescission of fiscal year 1987 budget authority and unobligated balances. Five-year savings would total $2.6 billion for the CDBG program and $0.9 billion for UDAGs, relative to the CBO baseline.

Rental Housing Development Grants (HoDAGs) would be terminated in 1988, following a rescission of the total 1987 appropriation of about $100 million and $10 million of recaptured funds. The Administration is also proposing to rescind $125 million of the $200 million appropriated for 1987 for rental rehabilitation grants, with the program continuing at an annual level of $75 million in 1988 and beyond. Other programs that would be terminated in 1988 are CDBG Section 108 guaranteed loans and Section 312 rehabilitation loans.

The President's budget also proposes the sale of various community development loans. The complete portfolio of the Section 312 rehabilitation loan program would be sold over two years, beginning in fiscal year 1988. The complete portfolio of public facility loans currently held by the Department of Housing and Urban Development would be sold over three years, beginning in fiscal year 1987. Receipts from loan sales are estimated to total $0.4 billion over the 1988-1992 period.

Area and Regional Development. The President's budget proposals for area and regional development programs, which are largely aimed at rural areas, would result in savings of $5.8 billion relative to the CBO baseline--a de-

crease from baseline levels of about 42 percent over the 1988-1992 period. The Administration is proposing to eliminate future direct loan and loan guarantee activity of the Rural Development Insurance Fund (RDIF), and to rescind $319 million of fiscal year 1987 direct loan authority. (The RDIF currently provides loans for water and waste disposal and other community facilities, and loan guarantees for business and industrial development.) Appropriations for 1987 currently provide for $426 million in direct loans and $114 million in guarantees. Outlay savings over five years would total $2.6 billion.

Other major programs that the Administration would terminate in fiscal year 1988 are rural water and waste disposal grants, economic development assistance grants, and Appalachian regional development grants, with fiscal year 1987 rescissions of about $80 million, $124 million, and $31 million, respectively. Lending activities of the Rural Telephone Bank (RTB) would be phased out by fiscal year 1990; beginning in fiscal year 1988, the federal government would no longer purchase RTB capital stock. Spending reductions are proposed for the Tennessee Valley Authority programs not related to power, the Bureau of Indian Affairs' construction program, and many smaller programs.

The President is also proposing the sale of RDIF and RTB loan assets. In each year from 1990 through 1992, $1 billion in principal value of RDIF loans would be sold. (These sales would be in addition to those mandated by the Omnibus Budget Reconciliation Act of 1986.) For the RTB, $500 million in principal value of loans would be sold in 1988 and in 1989, with an additional $250 million for sale in 1990. CBO estimates that receipts from these sales would total $2.1 billion over the 1988-1992 period.

Disaster Assistance. The President's proposals for disaster assistance would result in savings of $0.6 billion relative to the CBO baseline during the 1988-1992 period. The major proposal in this category is the sale of the disaster loan portfolio of the Small Business Administration (SBA) over six years, beginning in fiscal year 1987. The President is also proposing to raise the interest rate on disaster loans to the Treasury rate plus 1 percent, and to limit SBA disaster loans in fiscal year 1989 and beyond to those persons unable to obtain credit elsewhere. Finally, the budget contains an increase of 17 percent in flood insurance premiums in 1987, intended to make the program actuarially sound.

CBO Reestimates

The difference of roughly $300 million in fiscal year 1988 is largely attributable to differences in spending rates for the CDBG program and in estimated receipts from the sale of rehabilitation loans. The differences in fiscal years 1989 through 1992 primarily result from different estimates of receipts from RDIF loan sales and CBO's inclusion of prepayment penalties from RDIF to the Federal Financing Bank (FFB) for the early redemption of certificates of beneficial ownership. (While required under the agency's contracts with the FFB, such prepayment penalties were not included in the budget. They have no net effect on budget outlays, however, because they are precisely offset by receipts in function 900.)

Credit Programs

The CBO baseline projects direct loan obligations of about $1.2 billion in 1992, largely for SBA disaster loans and RDIF rural development loans. As shown in the following table, the President is proposing to end most lending activity in this function. By 1992, under the President's proposals, direct loan obligations would be reduced to $0.4 billion, largely for SBA disaster loans.

MAJOR CREDIT PROGRAM CHANGES PROPOSED FOR FUNCTION 450: COMMUNITY AND REGIONAL DEVELOPMENT
(By fiscal year, in billions of dollars)

Item	1988	1989	1990	1991	1992	Cumulative Five-Year Changes
			Direct Loan Obligations			
CBO Baseline	1.1	1.1	1.1	1.2	1.2	
Proposed Changes						
Rehabilitation Loans	-0.1	-0.1	-0.1	-0.1	-0.1	-0.4
Rural Development Insurance Fund	-0.4	-0.5	-0.5	-0.5	-0.5	-2.4
Rural Telephone Bank	-0.1	-0.1	-0.2	-0.2	-0.2	-0.7
Small Business Administration (Disaster Loans)	0	a/	a/	a/	-0.1	-0.2
Other	a/	a/	a/	a/	a/	a/
Total	-0.6	-0.7	-0.8	-0.8	-0.8	-3.7
President's 1988 Budget as Estimated by CBO	0.5	0.4	0.4	0.4	0.4	

a. Less than $50 million.

FUNCTION 500: EDUCATION, TRAINING, EMPLOYMENT, AND SOCIAL SERVICES

MAJOR SPENDING CHANGES PROPOSED FOR BUDGET FUNCTION 500: EDUCATION, TRAINING, EMPLOYMENT, AND SOCIAL SERVICES
(By fiscal year, outlays in billions of dollars)

Item	1988	1989	1990	1991	1992	Cumulative Five-Year Changes
CBO Baseline	32.6	34.7	36.4	37.8	39.1	
Proposed Changes						
Elementary and secondary education	-0.9	-2.0	-2.2	-2.7	-3.3	-11.1
Higher Education						
Student aid	-1.5	-2.2	-3.1	-3.4	-3.7	-13.9
Guaranteed Student Loans	-0.8	-1.0	-1.4	-1.6	-1.7	-6.6
College housing asset sales	-0.4	-0.1	-0.1	-0.1	-0.1	-0.7
Other	-0.1	-0.3	-0.3	-0.4	-0.4	-1.6
Arts and humanities	-0.1	-0.2	-0.3	-0.4	-0.5	-1.4
Training and employment	0.1	0.5	0.1	-0.2	-0.5	-0.1
Social services	-0.5	-0.7	-0.9	-1.2	-1.5	-4.9
Total	-4.1	-5.9	-8.4	-10.0	-11.7	-40.2
President's 1988 Budget as Estimated by CBO	28.5	28.7	28.0	27.8	27.4	
President's 1988 Budget	28.4	28.9	28.0	27.5	26.5	
CBO Reestimates	0.0	-0.1	0.0	0.3	0.9	1.0

Proposed Policy Changes

Under the policies set forth in the President's 1988 budget for education, job training, employment, and social service programs, federal spending would

decline by $4.1 billion in 1988 from CBO's baseline projection of $32.6 billion. By 1992, spending in function 500 would be reduced by $11.7 billion, or approximately 30 percent. As in previous budgets, the President proposes major reductions in federal education programs, and smaller reductions in job training, employment, and social services programs. The President also proposes $2.8 billion in 1987 rescissions. The 1988 budget includes new proposals for elementary and secondary education, higher education, youth employment, and worker assistance programs.

Elementary and Secondary Education. Over the next five years, the President's budget would reduce spending for elementary and secondary education by $11 billion, or 23 percent, below the CBO baseline. The Administration proposes to limit any federal role in elementary and secondary education to programs specifically targeted toward poor and disadvantaged children. To this end, the 1988 budget would eliminate many programs, while substantially reducing or freezing others.

The President proposes to eliminate the vocational education program, where half of the funds are not specifically targeted toward the disadvantaged. Savings below baseline would equal $4.2 billion from 1988 through 1992. Similarly, the budget would eliminate funding for Impact Aid "b", math and science programs, regional desegregation assistance centers, immigrant education, and many other smaller categorical programs. In addition, the President's budget would reduce spending substantially for drug-free schools by approximately $650 million over the projection period. Funding for Chapter 2 block grants, Impact Aid "a" payments, Indian education programs, and bilingual education would be frozen at 1987 levels.

The President proposes to reduce funding for all education programs for handicapped children. Funding for the newly created program for handicapped infants would be eliminated. Savings below baseline would total $1.9 billion from 1988 through 1992.

The President has requested $4.1 billion for compensatory education in 1988, approximately the CBO baseline level. Funding would be held at this level in the out-years. The President is requesting legislation to give local school districts the option to use compensatory education certificates to provide services. These certificates would give the parents of disadvantaged children some flexibility in choosing compensatory services. Currently, these children receive services at their assigned school.

Only in two small education programs is funding requested above baseline levels. The President's request of $130 million for adult education

represents an 18 percent increase over 1987. Requested funding would increase to $200 million by 1992. The President also requests $80 million of new funding in 1988 for teacher training grants to improve subject competence and teaching skills.

The Administration's elementary and secondary education request includes 1987 rescissions totaling $842 million. Spending would be reduced 10 percent below the CBO baseline in 1988, and 30 percent by 1992.

Higher Education. The President proposes major reforms to limit sharply the federal role in higher eduction. These proposals are a significant change from the policy directions contained in the Higher Education Admendments of 1986, a sweeping overhaul of all federal higher education programs. The newly enacted law increases basic grants to disadvantaged students, maintains most other grant and work aid programs in their current form, and substantially alters the Guaranteed Student Loan (GSL) program by tightening eligibility requirements, reducing lender yields, requiring fees for guarantors, installing stricter policies to pursue defaulters, and increasing borrowing limits.

Under the Administration's 1988 budget proposals, most aid to students and to colleges would be reduced substantially or eliminated. Remaining student aid would primarily consist of loans rather than grants and jobs. Loans would become more expensive and harder to find. Specifically, the President proposes to:

- Cut Pell grant funding by 33 percent below the 1988 baseline estimate of $4 billion. The proposal would remove approximately 1 million students from the program, primarily by tightening income eligibility requirements and increasing expected family contributions.

- Eliminate funding for supplemental grants, state student incentive grants, and work-study programs totaling $1.1 billion in 1988. Over 800,000 students, many the most needy, would no longer receive grant and job aid.

- Replace Perkins loans (formerly National Direct Student Loans) with an unsubsidized income-contingent loan program increasing total capital availability by $400 million. This increase in funding could either provide loans for new recipients or could permit increases in loans for current borrowers. Many current borrowers would require additional loan funds to compensate for reductions in grant aid.

- Eliminate most GSL interest subsidies, reduce annual borrowing limits, decrease lender yields, increase lender risks, and establish insurance premiums for students. The Administration would expand eligibility and borrowing limits in the supplemental loan program. CBO estimates that the net impact of these changes would reduce loan availability (discussed below under credit programs).

- Eliminate or reduce funding by $330 million in 1988 for most fellowship programs and other college aid such as the Jacob Javits, Patricia Harris, and Christa McAuliffe fellowships; the Upward Bound program; talent search; foreign language studies; and support for developing and historically black colleges.

These changes in higher education would begin in 1987 with proposed rescissions totaling $1.5 billion. As a result, federal spending for higher education programs would decline by approximately $2.4 billion in 1988 and $5.9 billion in 1992, a 60 percent reduction from CBO's baseline.

The President also proposes to sell more college housing and facilities loans in 1988 than are necessary to achieve the proceeds target under current law. Under the Higher Education Amendments of 1986, the Department of Education is directed to sell enough loan assets back to borrowers and to private investors to achieve sale proceeds of $314 million in 1988. The President would sell more of the portfolio, returning an estimated $675 million in proceeds in 1988.

Arts and Humanities. Arts and humanities programs, which currently account for federal spending of $1.4 billion, would be reduced below CBO's baseline by approximately 4 percent in 1988 and almost 28 percent in 1992. The proposed reductions include the elimination of funding for libraries and public telecommunications, a sharp decline in support for public broadcasting, and cutbacks in the federal endowments for the arts and humanities.

Training and Employment. The President's budget proposes to increase funding in 1988 for employment and training to finance new initiatives for dislocated workers and disadvantaged youth, but this increase is offset in later years by freezing or reducing funding levels for current programs.

In 1987, the Administration requests a $332 million rescission in employment and training funds. The rescission would reduce grants to states and would cut back the current dislocated worker and Summer Youth programs until new initiatives are in place. The activities of the Work

Incentive (WIN) program would be funded in the Administration's proposed new work/welfare program for recipients of Aid to Families with Dependent Children (AFDC) in the income security function (function 600).

The President's budget proposes two new initiatives to help dislocated workers--those who have worked for several years and whose jobs have been eliminated--and disadvantaged youth. The new Worker Adjustment Assistance Program would replace the trade adjustment assistance cash benefits and training programs with a single discretionary program focusing on counseling, job search, literacy, and skill training. The program would emphasize adjustment to new jobs and new careers. Budget authority of $980 million--$606 million more than the CBO baseline estimate for the existing programs--is requested in 1988. The second major legislative proposal would replace the Summer Youth program with a program allowing localities areas to choose a mix of services that best meet their needs. The states could choose to establish a more intensive year-round program for teenagers in AFDC families, to continue the existing subsidized summer jobs program for economically disadvantaged youth, or both.

Social Services. The President proposes to reduce current spending of $7.7 billion for social service programs by 7 percent in 1988 and 16 percent in 1992. In 1987, $127 million in vocational rehabilitation services would be rescinded. These cuts are in line with those proposed by the President in recent years.

The reductions reflect a number of program changes. The President proposes to consolidate 26 social services programs such as Head Start and meals for older Americans, reducing their total spending by 11 percent in 1988 and 23 percent in 1992. The Community Services Block Grant would be phased out by 1992. In the foster care and adoption assistance programs, payments to states for administrative and training costs would be limited to 50 percent of benefit payments, and the new independent living program would be eliminated. The President would also reduce funding for vocational rehabilitation grants.

CBO Reestimates

The CBO reestimates of the President's budget occur mainly in the GSL program. CBO projects higher interest rates than the Administration and thus higher interest subsidies in the GSL program. The economic differences are particularly significant in 1991 and 1992, when the CBO interest rate projections exceed the Administration's by over one percentage point. Of the $0.9 billion CBO reestimate in 1992, $0.6 billion results from

the higher interest rates assumed by CBO. An additional $0.2 billion reestimate in 1992 relates to spending projections of the Immigration Reform Act of 1986. These projections, however, are highly uncertain.

Credit Programs

Direct Loan Obligations. The President proposes to reduce direct loan obligations in function 500 by $1 billion over the next five years. In the GSL program, federal payments for default claims are considered direct loans of the federal government. These default claims are projected to total $6.8 billion over the next five years. The President's proposed reform of the GSL program would lower federal default payments by $655 million over five years by reducing maximum federal insurance coverage from 100 percent to 80 percent and by reducing borrowing and hence future liabilities. Net federal defaults after collections of insurance premiums and default repayments, not reflected in these gross totals, would be reduced by $3.3 billion over the time period by charging students a 9 percent insurance premium on regular loans and 2 percent on supplemental loans.

The President has also proposed to rescind the 1987 loan obligation authority of $60 million for the college housing program and to terminate the authority in the out-years. In addition, the President proposes in 1988 to sell more of the existing loans.

As part of its student aid reform package, the Administration has expanded the current income-contingent loan program with reduced subsidies to replace the Perkins loan program (formerly the National Direct Student Loan program). This proposed program would allow students to borrow their interest payments while in school and then would allow repayments to vary with earnings after school. In 1988, the President proposes to make a $600 million federal contribution to this program, a $400 million increase over the CBO baseline level.

Guaranteed Loan Commitments. Under the GSL program, the federal government fully guarantees private loans (estimated at $8.4 billion in 1988) for eligible students at highly subsidized and variable interest rates and also guarantees loans under the much smaller (estimated at $600 million in 1988) and less subsidized supplemental loan program. The Administration's proposed GSL reforms are aimed at eliminating all federal costs and liabilities associated with these programs. The Administration would shift all interest and default costs to students, lenders, and state guarantee agencies; reduce overall interest on regular guaranteed loans by 50 basis points; and lower regular program borrowing limits.

Guaranteed loan volume would decline by an estimated $1.8 billion in 1988 and an estimated $1.5 billion in 1992. The reductions would result primarily from lower borrowing limits and lower lender participation in the regular loan program. Reaction of private lenders to the proposed changes is uncertain. The combination of lower yields and higher risks, however, would force some small and medium-size lenders out of the program. Those lenders that remain would become more selective in choosing borrowers. CBO estimates that approximately 20 percent of 3.1 million eligible students would not receive loans under the President's reforms. For those students who receive loans, the amount of the loan available to pay for tuition, books, and fees would be reduced by 20 percent, declining from an estimated $2,650 to $2,100 for an undergraduate student in 1988. The decline reflects not only reductions in loan limits, but increases in interest payments and assessed insurance fees.

The Administration assumes that students would be able to recover their lost assistance from the supplemental loan program. CBO, however, expects only a minimal increase in supplemental loans since the expansion in private loan resources is unlikely to be large. The supplemental loan program has never been attractive to private lenders, and its current new loan volume is only about $600 million. Moreover, it has become even less attractive because the Education Amendments of 1986 reduced yields and increased administrative costs, and the President's proposals would increase lender risk.

MAJOR CREDIT PROGRAM CHANGES PROPOSED FOR FUNCTION 500: EDUCATION, TRAINING, EMPLOYMENT, AND SOCIAL SERVICES
(By fiscal year, in billions of dollars)

Item	1988	1989	1990	1991	1992	Cumulative Five-Year Changes
Direct Loan Obligations						
CBO Baseline	1.6	1.6	1.6	1.7	1.7	
Proposed Changes						
Guaranteed Student Loans	0.0	-0.1	-0.1	-0.2	-0.3	-0.7
College housing	-0.1	-0.1	-0.1	-0.1	-0.1	-0.4
Income-contingent loans	0.5	0.5	0.4	0.4	0.4	2.2
Total	0.4	0.3	0.2	0.2	0.1	1.2
President's 1988 Budget as Estimated by CBO	2.0	2.0	1.9	1.8	1.8	
Guaranteed Loan Commitments						
CBO Baseline	9.1	9.1	9.2	9.2	9.2	
Proposed Changes						
Guaranteed Student Loans						
Regular	-2.0	-1.9	-1.8	-1.8	-1.8	-9.3
Supplemental	0.2	0.3	0.3	0.3	0.3	1.4
Total	-1.8	-1.5	-1.5	-1.5	-1.5	-7.9
President's 1988 Budget as Estimated by CBO	7.4	7.6	7.6	7.6	7.6	

FUNCTION 550: HEALTH

MAJOR SPENDING CHANGES PROPOSED FOR BUDGET FUNCTION 550: HEALTH (By fiscal year, outlays in billions of dollars)

Item	1988	1989	1990	1991	1992	Cumulative Five-Year Changes
CBO Baseline	44.1	48.1	52.1	56.2	60.6	
Proposed Changes						
Medicaid						
Cap spending a/	-1.0	-2.6	-3.9	-5.3	-6.8	-19.7
Reduce higher match rates	-0.4	-0.4	-0.5	-0.5	-0.5	-2.3
Other	0.1	0.1	0.1	0.1	0.1	0.4
Subtotal	-1.3	-3.0	-4.3	-5.7	-7.3	-21.6
Public Health Service	-1.1	-1.7	-2.1	-2.7	-3.2	-10.7
Federal Employees Health Benefits	-0.5	-0.6	-0.7	-0.8	-0.8	-3.3
Other	-0.4	-0.4	-0.4	-0.4	-0.4	-2.1
Total	-3.3	-5.6	-7.5	-9.6	-11.7	-37.8
President's 1988 Budget as Estimated by CBO	40.8	42.5	44.5	46.7	48.8	
President's 1988 Budget	38.9	40.4	42.2	43.9	45.6	
CBO Reestimates	2.0	2.1	2.4	2.7	3.2	12.3

a. These estimates assume the cap is set at $1 billion below CBO's estimates of current law spending. Savings would be greater if the cap is set at $1 billion below the Administration's estimate of current services.

Proposed Policy Changes

The President requests sharp cuts in the health area, capping both federal Medicaid and Public Health Service spending. Most of the proposals have been submitted by the President in previous budgets and have not been approved by the Congress. More than half of the President's suggested cuts again would occur in Medicaid, the largest program in this function. Medicaid spending would be reduced by at least 4 percent in 1988 and by almost 17 percent in 1992. Public Health Service programs would be cut by one-quarter in 1992. Changes in the Federal Employees Health Benefits (FEHB) program would reduce federal costs by more than one-quarter in 1992.

Medicaid. The President has requested a number of changes in Medicaid that would reduce spending relative to the CBO baseline by at least $1.3 billion in 1988 and $21.6 billion over the projection period. One proposal would cap federal Medicaid payments to states at $1.0 billion below estimated current law spending and would limit future increases in federal payments to no more than the increase in the medical services component of the Consumer Price Index (MCPI). CBO estimates that the proposed cap on Medicaid spending would save $19.7 billion over the five-year projection period. This estimate assumes that the cap is set at $1.0 billion below CBO's baseline for Medicaid spending. If legislation were to set the cap at $1.0 billion below the Administration's estimate of current services, savings from the CBO baseline would be greater, totaling $31.8 billion over the projection period. In function 570, the President proposes to increase Medicare premiums, which Medicaid pays for some of its recipients. These higher premiums would increase Medicaid costs by about $0.6 billion in 1988. With the proposed cap on the federal share of Medicaid costs, however, higher Medicare premiums would have to be absorbed entirely by states that exceed their federal allotment.

The rate at which states' Medicaid expenditures are matched by the federal government is determined by a formula specified in law. Expenditures for certain administrative and medical services--development of computerized management and payment systems and family planning services, for example--are currently matched at higher rates. The President would eliminate these special rates. Reducing the higher match rates would lower federal payments to states by $2.3 billion over the projection period.

The President also proposes to place further limits on Medicaid coverage of people in public institutions and to encourage states to cover their Medicaid recipients through organizations, such as health maintenance organizations (HMOs), that provide health care on a fixed, prepaid basis.

These changes would not reduce federal payments because CBO assumes that states would not be able to achieve savings beyond the cap. The President also requests a demonstration project to reduce infant mortality, which would cost $85 million a year.

Public Health Service. The Administration proposes to cap spending for the Public Health Service at the 1987 level. This action would result in savings over five years of $10.7 billion below the CBO baseline. Most of this reduction is achieved through limiting research funding for the National Institutes of Health (NIH). The President's proposal would maintain about 19,100 NIH research grants a year, about 700 fewer than were supported by the 1987 appropriation. A reappropriation of $0.3 billion is requested, shifting funding from 1987 into 1988 in order to reach the lower grant level. The President also proposes to change significantly the way in which NIH research grants are funded. Many of the grant awards made by NIH are for projects involving several years of research. The Congress currently funds these grants for one year at a time. Beginning in 1988, the Administration would ask Congress to provide an additional $2.7 billion in appropriations in advance to pay for the future-year expenses of new grants awarded in 1988. Outlays would not be affected by this change because research expenses would continue to be paid when incurred.

The President again proposes to eliminate most grants for the education of health professionals and almost all funding for construction of Indian health facilities. The federal government would guarantee only 80 percent of the value of Health Education Assistance Loans and would reduce new guarantees by two-thirds, also suggested last year.

New proposals for reducing the budget include phasing out the National Health Service Corps and selling assets in both the Health Maintenance Organization and Medical Facilities loan programs. The Anti-Drug Abuse Act of 1986 provided the Public Health Service with an additional $0.3 billion in 1987 for drug abuse research, treatment, and prevention. The Administration does not request any additional funding for these supplemental activities but assumes that 1987 monies will be available in 1988.

Although total spending for the Public Health Service remains capped through 1992, the President has requested a 28 percent increase in federal funding for Acquired Immune Deficiency Syndrome (AIDS) research and prevention.

Federal Employees Health Benefits (FEHB). The Administration would lower the federal government's contribution for federal employees' health insur-

ance premiums by changing the formula used to determine contributions. The proposal would tie the government's share of costs to the average of premiums in all FEHB plans, rather than, as under current law, to the average of premiums in only the six largest, high-option plans. The formula would also be weighted by the distribution of employees among all plans. This plan would lower the government's share of health insurance costs by shifting about $0.2 billion in costs from the government to federal employees in fiscal year 1988. About one-third of these savings appear in the health function. The rest of the savings accrue in the allowances function (920) as a result of lower personnel costs for government agencies.

In addition, the Administration proposes that the U.S. Postal Service (USPS) and the District of Columbia pay the government's contribution for postal and District retirees' health premiums. FEHB payments would be lowered by $0.4 billion in fiscal year 1988 and by a total of about $2.8 billion over the next five years. The USPS would be required to contribute more than $2.7 billion of this amount, and the District of Columbia would contribute the remainder.

Other. In other health-related areas, the Administration proposes to charge fees for services provided by the Food Safety and Inspection Service (FSIS). Fees would be set to recover the full cost of FSIS activities, thereby reducing outlays in the President's budget in $0.4 billion below the CBO baseline in each year.

CBO Reestimates

CBO has reestimated the President's budget request upward by $2.0 billion in 1988 and $3.2 billion in 1992. Nearly all of this upward change occurs in the Medicaid program.

CBO's Medicaid baseline in 1988 is $1.8 billion higher than the Administration's estimates of current services. This difference results entirely from differing assumptions about the rate of growth in the Medicaid program from 1986 to 1988. CBO's Medicaid baseline increases almost 10 percent each year from 1986 through 1988, based on the average annual rate of growth of 9.5 percent over the last four years and the most recent growth rate of 10.3 percent between 1985 and 1986. CBO's higher baseline is also consistent with recent federal legislation that expanded the number of people eligible for Medicaid and with similar recent program expansions by a number of states. The Administration's estimates of current Medicaid spending assume a rate of growth of only 7 percent from 1986 to 1987 and of 5.6 percent from 1987 to 1988.

CBO has estimated the President's 1988 Medicaid request by reducing the CBO baseline by $1 billion. In future years, this 1988 level is increased by the percent change in the MCPI. The CBO reestimates for 1989 through 1992 reflect both the higher 1988 program level and the higher assumed growth in the MCPI. Reestimates in the Medicaid program total $1.9 billion in 1988 and $3.0 billion in 1992. Almost all of this reestimate results from CBO's assumption of a higher 1988 program level, with only one-quarter of the increase in 1992 resulting from higher assumed growth in the MCPI.

FUNCTION 570: MEDICARE

MAJOR SPENDING CHANGES PROPOSED FOR BUDGET FUNCTION 570: MEDICARE (By fiscal year, outlays in billions of dollars)

Item	1988	1989	1990	1991	1992	Cumulative Five-Year Changes
CBO Baseline	83.1	92.6	104.4	117.0	130.9	
Proposed Changes						
Delay Outlays						
Slow reimbursement	-1.3	-0.2	-0.2	-0.2	-0.2	-2.1
Eliminate PIP	-0.7	-0.1	-0.1	-0.1	-0.1	-1.1
Subtotal	-2.0	-0.2	-0.3	-0.3	-0.3	-3.2
Reduce Reimbursements to Providers						
DRG reimbursement	-0.5	-1.8	-3.4	-5.1	-7.1	-17.9
Medical education	-1.2	-1.5	-1.7	-1.8	-2.0	-8.3
Capital	0.0	0.0	-0.6	-0.7	-0.8	-2.1
Physician payments	-0.2	-0.3	-0.4	-0.5	-0.6	-1.9
Repeal portions of OBRA 1986	-0.1	-0.1	-0.1	-0.1	-0.1	-0.4
Other	-0.1	-0.2	-0.3	-0.3	-0.3	-1.1
Subtotal	-2.1	-3.9	-6.3	-8.5	-10.9	-31.7
Add to Beneficiary Costs						
SMI premiums	-0.7	-2.3	-3.2	-4.2	-5.3	-15.6
SMI deductible	0.0	0.0	-0.1	-0.1	-0.1	-0.4
Eligibility delay	-0.2	-0.2	-0.2	-0.3	-0.3	-1.2
Subtotal	-0.9	-2.5	-3.5	-4.5	-5.7	-17.1
Miscellaneous Proposals						
Secondary payer	0.0	-0.1	-0.1	-0.1	-0.1	-0.3
Other proposals	0.0	0.0	-0.1	-0.2	-0.2	-0.5
Subtotal	0.0	-0.1	-0.2	-0.2	-0.3	-0.8
Total	-5.1	-6.7	-10.2	-13.5	-17.2	-52.7
President's 1988 Budget as Estimated by CBO	78.0	85.9	94.1	103.5	113.7	
President's 1988 Budget	73.0	81.1	87.9	95.9	104.4	
CBO Reestimates	5.0	4.7	6.2	7.6	9.2	32.8

Proposed Policy Changes

The President proposes a number of changes in Medicare that would reduce spending, relative to the CBO baseline, by $5.1 billion in 1988 and $52.7 billion over the projection period. These reductions would amount to a 10 percent reduction in projected Medicare spending over the 1988-1992 period. Many of the proposals have been included in previous budgets, but have not been approved by Congress. The budget also contains several proposals to repeal recent legislation in Medicare.

Over 40 percent of the savings in 1988 would come from shifting outlays forward into 1989. While these shifts would lower outlays in 1988, they would not alter the obligations of the federal government. Outlays would be only slightly delayed, not actually reduced. An additional 40 percent of the savings in 1988 are from reducing reimbursements to providers. The remaining savings would result from increases in beneficiary costs and other miscellaneous proposals.

Delaying Outlays. Under the Administration's policy, CBO estimates that $2 billion in outlays would be delayed from 1988 into 1989. While this delay would not affect total reimbursements to providers, it would affect the flow of funds to providers and could cause them some short-run cash problems. Two proposals in the budget delay outlays.

First, the Administration intends to pay its bills more slowly by increasing the number of days bills remain with the Medicare contractors responsible for processing claims. The Omnibus Budget Reconciliation Act of 1986 (OBRA-86) established maximum time periods in which most claims must be paid. The maximum is 30 days in 1987, 26 days in 1988, 25 days in 1989, and 24 days thereafter, with slightly shorter payment schedules for certain physician bills. The Administration plans to slow down payments so that the legislative limits become a minimum as well as a maximum. CBO's baseline does not reflect a slowdown because the intent of the legislation was to set only a maximum. Data recently collected by the Administration indicate that current payment practices are already within the legislative limits. The President's budget also proposes legislation to set a permanent schedule of 30 days for all providers. With these proposals, outlays would be reduced by $1.3 billion in 1988 relative to CBO's baseline.

Second, the President proposes that certain hospitals which serve a disproportionate share of low-income patients would no longer receive reimbursement on a Periodic-Interim-Payment (PIP) basis. Instead, they would be paid as their bills were submitted and processed, thus slowing down their

reimbursement by several weeks. This action would save $0.7 billion in 1988.

Both of the initiatives to delay outlays would remain in effect permanently, and would therefore shift required outlay payments each year into the next fiscal year. The result would be large savings in 1988 with much smaller savings in subsequent years. However, obligations and total federal outlays over time would not be reduced.

Reducing Reimbursements to Providers. The President's budget includes several proposals to reduce reimbursements to providers. Relative to CBO's baseline, these proposals are estimated to reduce outlays by $31.7 billion over the next five years. Over half of the savings ($17.9 billion) would result from legislative initiatives to lower the rate of growth in hospital reimbursement. The Administration would repeal a provision of OBRA-86 that set the rate of increase for diagnosis-related groups (DRGs) in 1988 at the rate of growth of prices in the market basket of goods and services for hospitals minus 2 percent (estimated by both the Office of Management and Budget (OMB) and CBO at 2.9 percent) and would then return the authority for setting the DRG rate of increase to the Secretary of Health and Human Services. The Administration assumes that the Secretary would set the rate of increase at 1.5 percent in 1988 and at one-half of the rate of growth of prices in the hospital market basket in 1989 and thereafter. CBO's baseline assumes the full increase in the market basket each year beginning in 1989.

Since the prospective payment system was implemented in 1984, the cumulative increase in DRG rates has not kept up with the hospital rate of inflation as reflected by the market basket. DRG rates have increased by about 7 percent, while the market basket will have increased by an estimated 11 percent by the end of fiscal year 1987. Nevertheless, hospitals have maintained financial viability as measured by average profit margins. It is uncertain whether hospitals have adjusted by changing their mix of services, or whether initial DRG payments were set too high. Initial DRG payments were based on 1981 data, but if more recent 1984 data had been used, CBO analysis suggests that payments would have been about 10 percent lower. Thus, using the 1981 data may have allowed some leeway in hospital reimbursement, but the longer-run effect of continued increases below projected price increases of the market basket is uncertain.

The budget includes savings of $8.3 billion over the projection period from lowering reimbursement for the direct and indirect costs of medical education in hospitals with teaching programs. Direct costs of medical education include payments such as residents' and teachers' salaries, classroom

expenses, and associated overhead. The change in direct payments would reduce the expenses that a hospital could claim by excluding all education costs of undergraduate nurses and allied health professionals, as well as classroom-related costs of intern and residency programs. Indirect payments compensate for costs such as the greater number of tests and procedures prescribed by interns and residents. The change in indirect payments would cut in half the current indirect teaching adjustment, which is based on the ratio of the number of residents and interns to the number of beds.

The President also proposes to change capital payments to hospitals by incorporating them into Medicare reimbursement to hospitals under the prospective payment system. This plan would be phased in with a two-year transition for hospitals' moveable equipment and a 10-year transition for fixed equipment. The proposal would be effective in 1988 but would be budget neutral until 1990. Savings from 1990 through 1992 are estimated at $2.1 billion.

Medicare payment for physician services continues to grow faster than the general economy. The President's budget proposes to reduce reimbursements for physician services. CBO estimates a savings of $1.9 billion over the projection period for these options. However, these estimates are preliminary and subject to change once details of the proposals become available.

The budget includes variations on proposals for physician payments previously submitted to the Congress and two new proposals. About 60 percent of the savings in physician reimbursement comes from the two new proposals. First, reimbursement for hospital services provided by radiologists, anesthesiologists, and pathologists would be paid through the hospital prospective payment system. Estimates of 1988 savings are only $10 million because a long lead time would be required to implement the complex administrative aspects of the proposal. Prospective reimbursement for these physicians could save an estimated $0.5 billion over the projection period. This estimate reflects a target established by the Administration, as details of the proposal were not available. Second, physicians who have not billed Medicare in the past would be paid 80 percent of the local prevailing charge for a service, rather than the average local charge. This proposal would save $0.7 billion over five years.

The Administration also continues to target certain physician services that are considered overpriced. For example, the Administration would reduce payments to physicians for cataract surgery by 13 percent, thereby saving $0.4 billion over the projection period. Other proposals would reduce reimbursements for certain "high-priced" physician services to be identified

at a later time by the Administration, limit the allowable variation in charges for a procedure across geographic regions, and reduce the differences in payments to specialists and nonspecialists for certain procedures. These proposals could save $0.3 billion over the projection period, although details of the proposals were not available.

The Administration proposes repealing the OBRA-86 provision that set facility rates for renal dialysis, as well as the provisions that changed reimbursement for services performed by optometrists, occupational therapists, and physician assistants. The repeal of these provisions would save $0.4 billion over the projection period.

Other legislative and regulatory initiatives would lower payments for clinical laboratory services, reduce charges for durable medical equipment, and eliminate return-on-equity allowances in Medicare payments to skilled nursing facilities and outpatient hospital departments. Savings estimates for these proposals total $1.1 billion over the projection period, almost 70 percent of which comes from the reduction in payments for clinical laboratory services.

Adding to Beneficiary Costs. Under current law, premiums will be set at 25 percent of program costs through 1988 and will increase by the Social Security cost-of-living adjustment (COLA) in future years. CBO's estimate of Supplementary Medical Insurance (SMI) spending is projected to increase faster than the COLA, so that over time beneficiary premiums will decline as a portion of program costs. By 1992, estimated premiums will cover 19 percent of program costs.

The budget would raise out-of-pocket costs to beneficiaries by increasing the SMI premiums and deductible. While past budgets have included proposals to increase premiums, this year's proposals distinguish between current and new enrollees for the first time. Current enrollees would pay 25 percent of program costs through 1992; new enrollees would pay 35 percent of program costs; and third-party payers, including state Medicaid programs, would pay 50 percent of program costs. The table below displays CBO's projections of the proposed monthly premiums. Estimated monthly premiums for the President's budget assume estimated savings from other Medicare proposals requested in the budget. These three proposals would generate additional offsetting receipts of $15.6 billion over the projection period.

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Estimated Monthly Premiums
(By fiscal year, outlays in dollars)

	1988	1989	1990	1991	1992
CBO Baseline	22.00	22.90	23.90	24.90	26.00
President's Budget as Estimated by CBO					
Current enrollees	21.70	24.00	26.50	29.30	32.30
New enrollees	30.30	33.50	37.10	41.00	45.20
Third-party payers	43.30	47.90	53.00	58.60	64.50

The current SMI deductible is $75 per year and has not been increased since 1982, while program costs have nearly doubled. Approximately 70 percent of Medicare enrollees meet the deductible each year. The President would increase the deductible each year by the change in the Medicare Economic Index (MEI). The deductible would be $79 in 1988 and increase to an estimated $88 in 1992, saving $0.4 billion over the projection period.

Finally, beneficiary costs would increase because Medicare eligibility for the elderly would be delayed one full month. Five-year savings, including lost SMI premiums, would total $1.2 billion.

Miscellaneous Proposals. Other proposals in the budget would save $0.8 billion over the projection period. The Congress recently enacted legislation that makes Medicare the secondary payer for the working elderly and disabled and their dependents who elect to take advantage of employer-provided health insurance. Previous legislation for the disabled affected only firms employing more than 100 workers. The President's budget would extend this requirement to medium-sized firms employing 20 or more workers, thus saving $0.3 billion over five years.

Other proposals include a voucher program and inclusion of state and local employees hired before March 31, 1986, in the Medicare program. In addition, savings would accrue because the Administration proposes to cap growth in administrative expenditures over the projection period.

CBO Reestimates

CBO reestimates raise the President's Medicare budget by $5.0 billion 1988 and by $9.2 billion in 1992. These differences represent 6 percent and 8 per-

cent, respectively, of total Medicare spending in the President's budget in those years. About $1.6 billion, or one-fifth, of the difference in 1992 is attributable to CBO's assumptions of higher inflation rates. The remaining differences are technical.

By far the largest technical differences are in the Hospital Insurance (HI) program--$4.5 billion in 1988 and $8.1 billion in 1992. The reestimates in HI can be explained by differences in assumed annual growth rates and in the estimated 1986 HI program level. The CBO projections of HI spending assume a continuation of recent trends in the growth of hospital services. This growth results from many factors, including increases in caseloads, hospital admissions, disproportionate increases in expensive diagnoses, capital costs, home health services, and nursing services. The Administration's estimate assumes that growth in these factors will decline from recent experience. Taken together, these differences in assumed growth account for $2.6 billion (58 percent) of the 1988 reestimate and $6.6 billion (81 percent) of the 1992 reestimate.

A second difference arises because CBO used as the starting point for its projections the Department of Treasury's Monthly Treasury Statement for fiscal year 1986, while the Administration used different data, namely National Summary Forms (NSF). Recent NSF data omitted spending of health maintenance organizations, leading the Administration to underestimate 1986 outlays. As a result, CBO's estimates are $1 billion higher in 1988 and $1.5 billion higher in 1992.

Remaining estimating differences are small and relate primarily to reestimates of the President's legislative and policy initiatives. Estimates of many of these initiatives are highly uncertain and will remain so until legislative language precisely defines the policies.

FUNCTION 600: INCOME SECURITY

MAJOR SPENDING CHANGES PROPOSED FOR BUDGET FUNCTION 600: INCOME SECURITY (By fiscal year, outlays in billions of dollars)

Item	1988	1989	1990	1991	1992	Cumulative Five-Year Changes
CBO Baseline	131.4	138.8	144.4	153.6	162.6	
Proposed Changes						
Retirement and disability	-1.0	-1.2	-1.5	-1.8	-2.2	-7.6
Housing assistance	-0.3	-1.3	-1.6	-2.3	-3.0	-8.5
Nutrition	-0.9	-1.1	-1.2	-1.4	-1.6	-6.2
Family support payments	-0.5	-0.3	-0.1	0.1	0.5	-0.4
Food Stamps	-0.3	-0.3	-0.3	-0.1	-0.2	-1.3
Pension Benefit Guaranty Corporation	-0.3	-0.3	-0.2	-0.2	-0.2	-1.3
Low-income energy	-0.6	-0.7	-0.8	-0.9	-1.0	-4.0
Refugee assistance	-0.1	-0.1	-0.1	-0.1	-0.1	-0.6
Unemployment	-0.1	-0.1	-0.1	-0.1	-0.1	-0.5
Other	-0.2	-0.2	-0.2	-0.2	-0.3	-1.0
Total	-4.2	-5.7	-6.3	-7.2	-8.2	-31.6
President's 1988 Budget as Estimated by CBO	127.2	133.1	138.1	146.4	154.4	
President's 1988 Budget	124.8	128.7	133.5	138.9	143.6	
CBO Reestimates	2.5	4.5	4.6	7.5	10.9	29.9

Proposed Policy Changes

The President's proposals would reduce outlays for income security programs by $31.7 billion, or 4 percent, below the CBO baseline over the 1988-1992 period. Many of the proposals are similar or identical to those submitted in previous budgets.

Retirement and Disability. Since major reforms were enacted last year in both the civilian and military retirement programs, this year's budget proposes only moderate changes in current law which would produce estimated savings of $7.6 billion over five years. Some of these proposals were made in previous budgets but were not approved by the Congress.

The Administration again proposes to limit cost-of-living adjustments (COLAs) in the Civil Service and Foreign Service Retirement and Disability programs. This proposal would affect only civil servants retiring from the old Civil Service Retirement System (CSRS), not those participating in the newly created Federal Employees Retirement System (FERS). COLAs for these beneficiaries would be limited to the increase in the Consumer Price Index (CPI) minus one percentage point. By 1992, retirement benefits in these two programs would be about 5 percent lower under this proposal than under current law.

Another proposed reduction in civilian retirement would repeal the retirees' option to receive their contributions toward retirement in one lump-sum payment, with lower annuity checks in the future. This option was enacted for retirees in both CSRS and FERS as part of the Federal Employees' Retirement System Act of 1986, but no lump-sum payments have yet been made. Under current law, an average retiree selecting a lump-sum distribution could expect a payment of about $20,000 upon retirement, with a 10 percent reduction in his or her annuity each year thereafter. This proposal would allow benefits to be paid only in the form of an annuity. The President's federal retirement proposals would save an estimated $6.6 billion over the projection period.

The President's budget again includes Railroad Retirement proposals to freeze the 1988 cost-of-living adjustment for rail industry pensions, to reduce the COLA for certain pension benefits, and to have the rail sector finance 25 percent of the windfall subsidy payment. The Administration is also requesting increased payments into the rail industry pension fund to protect its solvency. These proposals would save $0.4 billion in outlays from 1988 through 1992.

Benefits in the Black Lung and Special Benefits for Disabled Coal Miners programs are indexed to changes in federal pay. The President proposes to freeze the COLAs for these programs in fiscal year 1988 and to limit them to half of federal pay raises in the following years. The President also proposes an increase in the coal tax, which provides a source of funds for the Black Lung program. These and other proposed reforms would lower outlays in the two programs by $0.6 billion below the CBO baseline over the five-year period.

Housing Assistance. The President has requested budget authority of about $5.3 billion to support the Department of Housing and Urban Development's low-income rental assistance programs. Based on 1987 appropriations, the CBO baseline includes about $9.4 billion for the same programs. The Administration also proposes to provide most of the additional assistance in the form of 5-year vouchers rather than the more traditional 15- to 20-year rental assistance contracts. Only limited additional funding would be provided for construction of housing for the elderly and handicapped and for public housing construction programs. The shift from construction programs and 15-year certificates to relatively short-term vouchers would allow assistance to an estimated additional 82,000 households in 1988, only about 5,000 less than assumed for the baseline.

The President's budget request would also cut budget authority for the public housing modernization program by roughly one-third in 1988 from the $1.5 billion level assumed for the baseline. Lower funding levels would continue, with $735 million assumed for 1989 and beyond. In addition, operating subsidies for public housing projects in 1988 would be funded at a level $200 million below that assumed in the baseline. Together, these changes would reduce spending by $8.9 billion over the projection period.

Low-income housing assistance in rural areas is also proposed for change in the President's budget. Direct loans provided by the Farmers Home Administration for the purchase of single-family houses or the construction or acquisition of multifamily rental properties would be replaced by housing vouchers. The vouchers, beginning in fiscal year 1988, would be used by low-income renters to meet a portion of rental costs. The budget includes funding for about 20,000 rental vouchers each year. This change would add about $0.4 billion to outlays over the five-year period.

Nutrition Programs. The Administration has again proposed to eliminate cash and commodity subsidies to children from families with incomes above 185 percent of the poverty level. In addition to this proposal, the Administration would cap extra payments for breakfasts and lunches served in

schools designated in "severe need," lower summer food rates to be comparable with rates in schools and child care centers, eliminate the Nutrition Education and Training program, and eliminate administrative funding for child care audits. These proposals would save an estimated $5.2 billion over the projection period.

Eliminating subsidies to children from families with incomes above 185 percent of the poverty level is estimated to save a five-year total of $4.7 billion. Subsidies would be eliminated for approximately 50 percent of the lunches and 10 percent of the breakfasts served in schools, 25 percent of the meals served in child care centers, 65 percent of the meals served in family day care homes, and 90 percent of the half-pints of milk served under the Special Milk program. In its estimate, CBO assumes that the reductions in federal subsidies would lead some schools to discontinue the program for all students, whereas the Administration assumes all schools would continue to participate. The savings resulting from schools dropping out of the program are relatively small ($350 million over five years), because the schools most at risk of dropping out are those serving relatively few meals to families with incomes below 185 percent of poverty.

Finally, funding for Nutrition Assistance for Puerto Rico would be $0.6 billion below baseline over the projection period, and funding for the Supplemental Food Program for Women, Infants, and Children (WIC) would be $0.3 billion below baseline levels.

Family Support Payments to States. The Family Support Administration (FSA) was created in April 1986, with responsibility for Aid to Families with Dependent Children (AFDC), Child Support Enforcement (CSE), and other programs that provide assistance to low-income families. The Administration has also created a new account--Family Support Payments to States--which includes the AFDC and CSE programs.

The President's budget again proposes a number of cuts in the AFDC program. The most far-reaching change would require many employable AFDC recipients to participate in a work-related activity, such as job search or workfare. The percentage of full-year recipients required to participate would rise from 20 percent in 1988 to 60 percent in 1992. While there is a growing body of evidence that AFDC work programs can be cost effective, the Administration's proposal differs significantly from existing state programs by requiring a larger number of people to participate for longer periods of time. This proposal is expected to produce lower cost savings per participant than have been experienced to date. In fact, CBO estimates that the proposal would result in net costs that increase over

time, reaching $756 million by 1992. In contrast, the Administration's estimate shows net savings that would reach $517 million by 1992.

Costs of administering the work programs are similar in the two estimates, but CBO's AFDC savings from the programs are only one-third of the Administration's. In addition, the CBO estimate includes a cost for AFDC savings lost because of the proposed repeal of the Work Incentive (WIN) program. The CBO estimates are based on the recent studies of AFDC work programs in Arkansas, California, Maryland, and Virginia undertaken by the Manpower Demonstration Research Corporation. The Administration's proposal was assumed to have lower savings per participant than existing state programs, however, because--given the participation requirement--programs would be less intensive, treat participants for lengthy periods, and require recycling of participants through work programs.

The proposed work requirement generates sizable savings in Medicaid, but these potential savings would not be realized by the federal government because the President's budget proposes a cap on the Medicaid program (see function 550). CBO also estimates that the work requirement would generate savings in the Food Stamp program. CBO estimates that the President's work proposal would cost $2.1 billion over five years in AFDC.

Most of the remaining AFDC proposals, like work requirements, have been proposed before. These proposals would remove an employable adult's benefit when the youngest child reaches age 16, require that most mothers under 18 years of age live with their parents, and tighten the definition of an "essential" person. Together these proposals would lower benefits for about 185,000 families while saving an estimated $125 million in 1988 and $660 million over five years.

Matching rates on costs for automatic data processing systems and on administrative costs in states where they are high (greater than 125 percent of the U.S. median) would be reduced. A new proposal this year would require the prospective withholding of fiscal sanctions imposed on the states for errors in AFDC payments. Several changes in regulations would also add to savings. Together these proposals would save $1 billion over five years.

The Administration also proposes to modify the Child Support Enforcement (CSE) program, which is still undergoing significant change as a result of the Child Support Enforcement Amendments of 1984. These amendments established a schedule of incentive payments to the states based on their ratios of child support collection to expenditure. Each state, regardless of its ratio, receives an incentive equal to at least 6 percent of child support

collections. The Administration's proposal would eliminate this automatic 6 percent incentive payment, lowering payments to states with ratios of less than 1.4. This proposal would affect an estimated 27 states and save about $100 million a year.

A second CSE proposal would require that states set guidelines on the amount of a family's child support award and that courts use this guideline as a "rebuttable presumption" in the setting of awards. Savings are estimated to rise from $25 million in 1988 to $140 million in 1992. However, because of the interaction between the two CSE proposals--that is, with higher collections, incentive payments would rise--savings would be between $20 million and $50 million a year lower than the sum of savings from the separate proposals. Savings from the two proposals would be $0.8 billion through 1992.

In addition, as in last year's budget, the match rate for administrative expenditures in CSE would be reduced in 1988 and 1989, as would the match rate on automatic data processing systems. These proposals would save $70 million over five years.

Food Stamps. The President's budget proposes to increase the amount of fiscal sanctions charged to states with high error rates and to collect the sanctions prospectively, based on projected error rates. Current collection efforts have been frustrated by state legal action. The proposal would save an estimated $0.3 billion in 1988 and $0.9 billion over five years. This estimate assumes that states would continue to appeal the sanctions, and that some of the withheld money would be returned to the states after appeal and litigation.

The Administration also proposes to lower Food Stamp benefits for households with energy assistance and training assistance, and to reduce federal funding for certain administrative costs. These proposals were included in last year's budget, and are estimated to save a five-year total of $0.3 billion. Effects on Food Stamps from the President's AFDC proposal are small in the aggregate because of offsetting costs and savings.

Pension Benefit Guaranty Corporation (PBGC). The President proposes a change in the PBGC's premium charges, from a flat premium of $8.50 per pension plan participant to a premium that would increase according to the unfunded liability in a private employer plan. Pension plans would pay a minimum of $8.50 per participant plus an additional amount for every $1,000 per participant of unfunded liability. The new structure would increase the average premium to an estimated $20 per plan participant and would reduce outlays by approximately $1.3 billion over the projection period.

Despite the tripling of the premium last year, which increases income to the PBGC by approximately $200 million annually, the PBGC is still in a precarious financial position. The extent of underfunding and the number of participants involved in the recent termination of LTV Corporation's pension plans was unprecedented for the PBGC. The estimated 1988 benefit payments for LTV alone are approximately $400 million--$100 million more than premium income from all plan participants. In 1989, under current law, the PBGC will be unable to meet its obligations from current income and revolving fund balances and will be forced to deplete assets in order to pay benefits. With no increase in premium income--or alternative changes--the assets, once expected to finance benefits for retirees many years into the future, would be depleted in an estimated five or six years.

Low-Income Home Energy Assistance (LIHEAP). The Administration requests $1.2 billion in 1988 appropriations for LIHEAP, $0.6 billion below the amount provided for 1987 and $0.7 billion below CBO's baseline projections for 1988. For future years, projected appropriation requests would remain at $1.2 billion, which could produce further outlay savings amounting to $3.4 billion for the projection period. The rationale given for the reduced appropriation request is that states have received money from settlements on oil overcharges that can be used for this program. The states have received $3.1 billion in settlements to date, and CBO estimates that $2.0 billion more will become available between now and 1992. While the total funds from these settlements appear to be sufficient to cover the reductions in energy assistance funding, the state distribution of the monies would be significantly different. The formula for distributing the monies from oil overcharges to states and the formula for distributing energy assistance are different. Based on some preliminary calculations, CBO estimates that eight states could receive a 100 percent increase in energy funds if their LIHEAP grants were replaced with oil overcharge settlement grants, while 11 states could lose over one-third.

Refugee Assistance. The Administration proposes a regulatory change to reduce the number of months for which it would reimburse states for their share of refugee assistance costs. It would reduce from 31 to 24 months the period for which it pays the state share of AFDC and Medicaid costs, and from 18 to 12 months the period for which it pays 100 percent of costs for refugees who receive General Assistance from states. In addition, the Administration would reduce federal funding for state administrative costs and social service grants, and would eliminate grants for targeted assistance. Finally, authority for education assistance would be transferred to the Department of Education in this fiscal year, where it is proposed to be re-

scinded. The proposals would reduce projected baseline costs by an estimated $0.6 billion over the next five years.

Unemployment Compensation. The President proposes eliminating the trade adjustment assistance program for workers affected by imports. This would save an estimated $0.5 billion from 1988 through 1992. The Administration requests funding for a new and comprehensive program to provide training services for dislocated workers and other workers. Funds for this new program are included in function 500 (education). The budget also discusses a proposal to decentralize the authority, financing, and administration of state unemployment insurance programs. The details of this proposal have not been developed, however, and the budget estimates do not reflect any change.

Other. The President's requests for administrative funds in the Family Support Administration, general departmental management, and the Supplemental Security Income program are below CBO's baseline.

CBO Reestimates

CBO reestimates raise the President's budget by $30 billion over the five-year period. About two-fifths of the reestimates reflect different economic assumptions--mainly CBO's assumption of higher COLAs and higher unemployment rates. Technical reestimates total $17.5 billion over the period, or 58 percent of the total CBO reestimates. Although there are relatively small downward reestimates in three major programs, most of the technical reestimates are upward.

The largest technical reestimate--totaling $7.9 billion over the five-year period--occurs in the Family Support Payments to States account, which includes the AFDC and CSE programs. In 1992, the Administration's estimate is increased by 25 percent. About two-thirds of the technical reestimate comes from differences in current service baselines, and one-third from differences in estimates of legislative savings.

Most of the baseline reestimate reflects differing assumptions about the rate at which states will increase benefit payments per family. CBO assumes that benefits will rise at a rate of 3.75 percent, which is lower than increases in recent years. The Administration uses a rule of thumb that ties benefit increases to a portion of the rise in the CPI. When the CPI is rising at a modest rate, as in the projected period, the estimated rise in benefit payments is quite low. In addition, CBO estimates that fewer fiscal sanc-

tions for error rates in benefit payments will be collected from the states, partly because of a slower collection schedule and partly because only two-thirds of sanctions are assumed to be collected as a result of legal review.

The reestimate of legislative savings is primarily in savings of the Administration's proposed work requirement for AFDC recipients. The two estimates diverge by growing amounts over time, so that by 1992 the difference is $1.3 billion.

CBO's reestimates of the refundable portion of the Earned Income Tax Credit (counted as a budget outlay) add $3.2 billion to spending over the 1988-1992 period. However, most of this difference is offset in the revenue estimates, which assume a smaller credit against taxes owed.

Civil Service Retirement accounts for the last major reestimate, totaling $3.6 billion through 1992. Though large in absolute terms, unlike reestimates in the two previous programs it reflects a relatively small increase (8 percent) in the Administration's 1992 estimate. Part of the reestimate relates to the Thrift Investment Fund, created by the Federal Employees' Retirement System Act of 1986. Beginning in April 1987, federal employees will be able to make tax-deferred contributions into the fund, and the federal government will match those contributions for certain employees, up to the limit specified in law. These employee contributions are treated as offsetting receipts to the federal government, reducing government spending. CBO assumes federal employees will make smaller total contributions into the Thrift Savings Fund, resulting in estimates of total receipts to the government that are between $0.2 billion and $0.3 billion lower than the Administration's in each year. Further, retirement and separation from federal employment results in payments from the Thrift Savings Fund. Because CBO has higher rates of retirement and separation in 1989 through 1992 than the Administration, payments from the fund are estimated by CBO to be $1.2 billion higher over the projection period. Finally, CBO has slightly higher estimates of benefit payments in the Civil Service Retirement and Disability program, accounting for $1.1 billion of the reestimate over the five-year period.

Remaining technical reestimates in function 600 total $2.6 billion over the five-year period. Unemployment compensation and Food Stamps account for most of this increase.

FUNCTION 650: SOCIAL SECURITY

MAJOR SPENDING CHANGES PROPOSED FOR BUDGET FUNCTION 650: SOCIAL SECURITY (By fiscal year, outlays in billions of dollars)

Item	1988	1989	1990	1991	1992	Cumulative Five-Year Changes
CBO Baseline	221.0	235.6	252.2	269.9	288.2	
Proposed Changes	-0.1	-0.2	-0.4	-0.4	-0.5	-1.6
President's 1988 Budget as Estimated by CBO	220.8	235.4	251.9	269.5	287.7	
President's 1988 Budget	219.4	232.5	246.8	261.5	275.5	
CBO Reestimates	1.4	3.0	5.1	8.0	12.2	29.7

Proposed Policy Changes

Although the Administration proposes no changes in Social Security benefits, the President's proposals would result in small reductions in outlays in this function during the next five years. The budget incorporates a continuation of the personnel reductions proposed in the last several budgets. In addition, the budget includes one change in the administration of the Social Security program and several changes in coverage under the payroll tax that would affect benefit payments slightly through 1992. The combined effect of these initiatives would save about $149 million in 1988 and about $1.6 billion over the next five years.

The staffing levels proposed by the President would reduce the Social Security Administration's (SSA) full-time equivalent (FTE) employment by 2,454 from 1987 to 1988, and by about 11,799 FTEs over the next five years. The proposed 1988 staffing level is about 92 percent of SSA's actual 1986 employment, and about 85 percent of that which prevailed in 1982.

With respect to administrative changes that would affect benefit payments, the SSA would alter its method of selecting for review Disability Insurance (DI) award decisions made by state agencies. The Administration's plan would replace the current selection procedure, which is essentially random, with one that would focus resources on cases where errors in the determination process are most likely to occur. As a result, future benefit payments would be affected, but by only $34 million over the next five years.

The proposed changes affecting Social Security revenues (discussed in further detail in Chapter III) would increase future benefit payments by covering more earnings under the payroll tax. In particular, coverage of inactive duty training for reservists in the Armed Forces would raise covered earnings for those workers affected and increase the eventual benefits received by most of these workers. Over the next five years, the additional benefits would be negligible (less than $5 million).

CBO Reestimates

CBO has reestimated the President's budget request upward by a total of $29.7 billion for the 1988-1992 period. Most of the difference (nearly 90 percent) results from the higher cost-of-living adjustments (COLAs) in the CBO economic assumptions: the Administration forecasts falling inflation over the next five years, while CBO expects inflation to stabilize between 4 percent and 4 1/2 percent.

Social Security Cost-of-Living Adjustments
Assumed by CBO and the Administration
(In percents)

	1988	1989	1990	1991	1992
CBO	4.1	4.3	4.4	4.3	4.3
Administration	3.5	3.6	3.6	3.1	2.7

CBO also assumes that the number of people receiving disability benefits will increase at a faster rate than the Administration, with the difference amounting to about 60,000 beneficiaries by 1992. This technical estimating difference adds $1.8 billion over five years to projected program costs.

FUNCTION 700: VETERANS' BENEFITS AND SERVICES

MAJOR SPENDING CHANGES PROPOSED FOR BUDGET FUNCTION 700: VETERANS' BENEFITS AND SERVICES

(By fiscal year, outlays in billions of dollars)

Item	1988	1989	1990	1991	1992	Cumulative Five-Year Changes
CBO Baseline	27.4	27.7	28.2	28.6	28.9	
Proposed Changes						
Loan Guaranty						
Increase origination fee	-0.4	-0.3	-0.3	-0.3	-0.3	-1.6
Sell loan portfolio	-0.2	-0.1	-0.1	0.2	0.2	a/
Medical Care	-0.2	-0.2	-0.3	-0.3	-0.3	-1.4
New GI Bill	0.2	0.1	a/	a/	-0.1	0.2
Other	a/	-0.1	-0.1	-0.1	-0.1	-0.5
Total	-0.7	-0.6	-0.8	-0.6	-0.6	-3.3
President's 1988 Budget as Estimated by CBO	26.7	27.1	27.4	28.0	28.3	
President's 1988 Budget	27.2	27.6	28.0	28.6	29.0	
CBO Reestimates	-0.4	-0.5	-0.6	-0.6	-0.7	-2.9

a. Less than $50 million.

Proposed Policy Changes

The President's 1988 budget for veterans' benefits and services proposes significant changes in the home loan guaranty program of the Veterans Administration (VA), as well as reductions in veterans' medical care and education benefits.

Loan Guaranty Revolving Fund. The President's 1988 budget proposes to increase the origination fee required of veterans and others obtaining VA guaranteed and direct loans from its current level of 1.0 percent of the mortgage principal to 2.5 percent. This increase would produce net outlay savings of $1.6 billion over five years. Increases in the loan origination fee were also proposed by the President in his 1986 and 1987 budget requests but were not approved by the Congress.

Also included in the President's budget is a policy change to sell to the public the VA's portfolio of direct loans. These loans, called vendee loans by the VA, were made by the agency to market properties acquired through foreclosure of VA-guaranteed loans. While the VA routinely sells vendee loans for which payments are current, the President also proposes to sell loans that have previously been considered unavailable for sale because of default or poor documentation. Even though this change would not require Congressional action, it is a significant policy change and is therefore not included in the CBO baseline.

In a separate but related change, the President's budget indicates that all vendee loan sales after 1987 will be made without recourse to the government in the event of default. In the past, the VA has guaranteed that loans that default after their sale would be repurchased by the agency. The CBO baseline also assumes loan sales without recourse.

Medical Care. Reductions from baseline spending levels also are proposed by the President for the medical care services provided by the Veterans Administration. The estimated outlay savings over five years would total $1.4 billion.

As part of the Consolidated Omnibus Budget Reconciliation Act of 1985 (Public Law 99-272), the Congress approved a number of changes in eligibility for VA health care. Certain groups of veterans--such as those with service-connected disabilities--and veterans with annual incomes below $15,000 per person ($18,000 per couple) are now entitled to VA health care. Veterans with annual incomes below $20,000 per person ($25,000 per couple) are eligible for free care on a space-available basis. Veterans with incomes above these levels are also eligible for care on a space-available basis but are charged copayments for such care. The President's budget would eliminate funding for this last category of veterans. The VA, however, maintains that the required spending cuts can be achieved through reductions in nonessential personnel and other expenses, with little change to the anticipated hospital patient load.

New GI Bill. The President is proposing to reauthorize the All-Volunteer Force Assistance program (New GI Bill) beyond the current June 30, 1988 expiration date. The CBO baseline also assumes the extension of this program. In addition, the President proposes to transfer funding of the basic $300 monthly benefit from the VA to the Department of Defense (function 050). While this shift would have no impact on budget totals, it would cause a net increase in function 700 outlays, because the current receipts from contributions are greater than current expenditures for benefits.

Compensation. Even though the compensation program is not indexed by law, its benefits historically have been increased for inflation each year through legislation. The CBO baseline includes these out-year inflation increases as a reflection of Congressional policy, and the President's budget proposes to index these benefits permanently. The President, however, assumes significantly lower cost-of-living adjustments (COLAs) than are reflected in the CBO baseline. Under CBO economic assumptions, outlays from compensation COLAs would be $1.2 billion higher over five years than under assumptions of the Office of Management and Budget (OMB).

CBO Reestimates

In the Loan Guaranty Revolving Fund, CBO assumes that the recent downward trend in defaults will accelerate as the economy improves. The OMB estimate appears to assume, however, that default rates will continue to be high. Because of these different assumptions, CBO's outlay estimates are $1.8 billion lower than the President's estimates over the five-year period. Lower projections of average benefits in the compensation and pension programs cause CBO estimates to be an additional $1.2 billion below the President's.

The CBO outlay estimates for 1988 through 1992 in the veterans' education programs are nearly $300 million below the President's, mainly because CBO estimates that fewer service members will contribute and train under the New GI Bill. The downward reestimate in the New GI Bill is partially offset by an upward reestimate in readjustment benefits, where CBO assumes that fewer veterans would exhaust their entitlement or reach their delimiting date during this period.

Credit Programs

Loan Guaranty Revolving Fund. The changes proposed by the President in the loan guaranty program would have a number of effects on the credit budget. The increase in the loan origination fee to 2.5 percent is expected

to reduce the demand for new guaranteed loans by approximately 7.0 percent; some borrowers will be unable to qualify for a mortgage after the higher fee is added to the mortgage principal, and other borrowers may find conventional financing more attractive. The President is also proposing to sell a higher percentage of acquired properties for cash, rather than financing the sales. This would reduce the number of new vendee loans established.

MAJOR CREDIT PROGRAM CHANGES PROPOSED FOR BUDGET FUNCTION 700: VETERANS' BENEFITS AND SERVICES
(By fiscal year, in billions of dollars)

Item	1988	1989	1990	1991	1992	Cumulative Five-Year Changes
Guaranteed Loan Commitments						
CBO Baseline	24.3	22.2	23.2	24.6	26.0	
Proposed Changes (Loan Guaranty)	-1.6	-1.6	-1.6	-1.7	-1.8	-8.4
President's 1988 Budget as Estimated by CBO	22.7	20.6	21.6	22.9	24.2	
Direct Loan Obligations						
CBO Baseline	1.2	1.1	1.0	0.9	0.7	
Proposed Changes (Loan Guaranty)	-0.1	-0.1	-0.1	-0.1	a/	-0.4
President's 1988 Budget as Estimated by CBO	1.1	1.0	0.9	0.9	0.7	

a. Less than $50 million.

FUNCTION 750: ADMINISTRATION OF JUSTICE

MAJOR SPENDING CHANGES PROPOSED FOR BUDGET FUNCTION 750: ADMINISTRATION OF JUSTICE
(By fiscal year, outlays in billions of dollars)

Item	1988	1989	1990	1991	1992	Cumulative Five-Year Changes
CBO Baseline	9.1	9.5	9.7	9.8	10.0	
Proposed Changes						
Legal Services Corporation	-0.3	-0.3	-0.4	-0.4	-0.4	-1.7
Criminal justice assistance	-0.1	-0.3	-0.4	-0.4	-0.4	-1.6
Federal law enforcement	0.1	-0.1	-0.2	-0.3	-0.3	-0.8
The Judiciary	0.2	0.2	0.2	0.2	0.2	0.8
General legal activities	0.1	0.1	0.1	0.1	0.1	0.6
Federal prison system	0.1	0.1	0.1	0.1	0.1	0.5
Other	a/	a/	0.1	0.1	0.1	0.3
Total	0.1	-0.3	-0.5	-0.6	-0.6	-2.0
President's 1988 Budget as Estimated by CBO	9.2	9.2	9.1	9.3	9.4	
President's 1988 Budget	9.2	8.9	8.8	8.9	9.1	
CBO Reestimates	a/	0.3	0.4	0.3	0.3	1.4

a. Less than $50 million.

Proposed Policy Changes

The President's budget proposals would increase funding for the administration of justice in 1988 and maintain spending at close to the 1988 level, but

below the CBO baseline, from 1989 through 1992. Spending on federal law enforcement is projected to decrease slightly, while spending on the judiciary and federal prisons would increase, relative to baseline levels. The elimination of funding for the Legal Services Corporation and justice assistance programs would reduce outlays by $3.3 billion over the 1988-1992 period and total savings for the function would be $2.0 billion over the five-year period.

Legal Services and Justice Assistance. The largest savings in the President's budget for function 750 comes from terminating federal funding for the Legal Services Corporation and eliminating certain justice assistance programs. As in previous years, the President proposes to end funding for the Legal Services Corporation, with savings of $300 million to $400 million annually relative to the CBO baseline; the five-year savings would be $1.7 billion. The Administration also proposes to eliminate the Office of Juvenile Justice and Delinquency Prevention, the state and local drug grant program, funds for incarceration of the Mariel Cubans, and regional information sharing, and to limit obligations from the Crime Victims Fund. The cumulative savings from these spending reductions would be $1.6 billion over the 1988-1992 period, with $1.2 billion of that amount attributable to the elimination of the drug grant program.

Federal Law Enforcement. The overall spending levels proposed by the Administration for federal law enforcement activities are slightly lower than the CBO baseline from 1988 to 1992. In total, law enforcement spending would be nearly $75 million (or 1 percent) above the baseline in 1988, but would fall to nearly $300 million (or 5 percent) below the baseline by 1992. The largest single increase is for the Immigration and Naturalization Service (INS) to implement the Immigration Reform and Control Act of 1986. The President's budget includes a $147 million supplemental in 1987 and a $245 million increase in budget authority in 1988 over the current 1987 appropriation. Outlays by the INS would increase by 44 percent in 1988 relative to 1987. The additional spending would cover increased border enforcement, enforcement of employer sanctions, the special agricultural workers programs, and verification programs. The President's budget also includes spending for the legalization program, which will be funded entirely from user fees. The Administration also has proposed a 7 percent increase in spending by the Federal Bureau of Investigation (FBI) for 1988, relative to the baseline. This increase would enable the FBI to purchase advanced equipment for the criminal investigations division and to construct new laboratories.

Funding for the United States Customs Service would be decreased under the President's proposals, primarily because no funds are requested for 1988 to cover activities funded in the Omnibus Drug Supplemental Appropriations Act of 1987. The agency's 1988 funding request is $110 million, or 10 percent, below the 1987 level. Proposed spending on salaries and expenses for the Customs Service is more than 10 percent below the CBO baseline each year, while spending for the Customs air interdiction program would be more than 50 percent below the baseline by 1992.

Judicial Activities and Federal Prisons. The President's budget includes additional spending for the courts, the Department of Justice's legal activities, and the operation of the federal prison system. Spending by the Judiciary would be approximately $0.8 billion (or 12 percent) above the baseline level from 1988 through 1992. Within the Department of Justice, the budget includes increases for general legal activities (including the United States Attorneys), the United States Marshals, and the expansion of the United States Trustees Program.

The Administration also proposes to increase spending on the federal prison system by approximately $500 million above the CBO baseline from 1988 through 1992. Spending for prison construction would decrease slightly relative to the baseline over this period, while spending for salaries and expenses would increase.

CBO Reestimates

Based on historical spending rates, CBO estimates slightly higher outlays ($1.4 billion over the five-year period) than the Administration for programs in this function.

FUNCTION 800: GENERAL GOVERNMENT

MAJOR SPENDING CHANGES PROPOSED FOR BUDGET FUNCTION 800: GENERAL GOVERNMENT (By fiscal year, outlays in billions of dollars)

Item	1988	1989	1990	1991	1992	Cumulative Five-Year Changes
CBO Baseline	6.9	6.9	7.2	7.4	7.4	
Proposed Changes						
Internal Revenue Service	0.4	0.6	0.6	0.5	0.4	2.5
Federal Buildings Fund	0.3	0.5	0.4	0.3	0.3	1.8
Legislative Branch	0.1	0.1	0.1	0.1	0.1	0.5
Federal Financing Bank	0.2	0.2	0.2	0.2	0.2	1.0
Federal Supply Service	-0.2	-0.2	-0.2	-0.2	-0.2	-0.9
Other	0.1	0.1	a/	a/	-0.1	0.1
Total	0.9	1.3	1.1	0.9	0.7	4.9
President's 1988 Budget as Estimated by CBO	7.7	8.2	8.3	8.2	8.1	
President's 1988 Budget	7.5	7.9	7.9	7.9	7.8	
CBO Reestimates	0.2	0.4	0.3	0.3	0.3	1.6

a. Less than $50 million.

Proposed Policy Changes

The President's budget includes increased funding for general government activities that would result in outlays $4.9 billion above the baseline over the 1988-1992 period. The largest increase is for the Internal Revenue Service (IRS), to implement the Tax Reform Act of 1986 and to fund several initiatives aimed at increasing revenue collections. These initiatives include hiring additional IRS staff to identify and collect taxes owed but not paid.

The President is requesting a 1988 appropriation for the IRS that is $0.5 billion above the baseline level. Over the five-year period, IRS outlays would be $2.5 billion, or 10 percent, above the baseline. The initiatives to increase revenue collections are estimated to produce $1.8 billion in additional revenues in 1988, and a total of $14.4 billion over the 1988-1992 period.

The President also proposes to use the increased rental income resulting from the 1988 reappraisal of federal office space to fund expanded building construction, acquisition, and repair projects through the Federal Buildings Fund. Additional spending for these activities would exceed baseline levels by $1.8 billion over the five-year period. The proposed appropriations for activities of the Legislative Branch would result in outlays that are $0.1 billion above the CBO baseline each year.

The budget includes a proposal, repeated from the 1987 budget, to show the surplus income of the Federal Financing Bank in the net interest function (900) of the budget rather than in the general government function. This change would increase general government outlays by $0.2 billion per year, but would have no net effect on the budget.

The major outlay savings estimated for this function involve the General Services Administration (GSA). The President proposes to recover fully the administrative costs of the GSA in supplying goods and services to federal agencies through the General Supply Fund. The GSA currently sells goods and services to agencies at cost, and the administrative expenses of managing this activity are funded by an appropriation to the Federal Supply Service. The budget proposal would eliminate this appropriation, and agencies would cover these expenses by paying a charge above the price of the goods or services they purchase from GSA. As a result, spending would decrease by a total of $0.9 billion through 1992.

CBO Reestimates

The budget assumes that renewed efforts to identify and sell surplus federal property would raise about $1.6 billion over the 1988-1992 period. Earlier attempts by the Administration to sell property fell substantially short of stated goals, and the lengthy process of declaring property as surplus makes drastic increases in the inventory of salable surplus property unlikely. CBO therefore estimates that surplus property sales will result in receipts of only $0.6 billion over the next five years, a slight increase over recent experience. For a number of other programs, CBO has estimated outlays greater than in the budget, based on historical spending patterns.

FUNCTION 850: GENERAL PURPOSE FISCAL ASSISTANCE

MAJOR SPENDING CHANGES PROPOSED FOR BUDGET FUNCTION 850: GENERAL PURPOSE FISCAL ASSISTANCE
(By fiscal year, outlays in billions of dollars)

Item	1988	1989	1990	1991	1992	Cumulative Five-Year Changes
CBO Baseline	1.9	1.9	2.0	2.0	2.1	
Proposed Changes						
Payments to states, mineral and timber receipts cost sharing	-0.2	-0.3	-0.3	-0.3	-0.3	-1.4
Payments to the District of Columbia	-0.1	-0.1	-0.1	-0.2	-0.2	-0.7
Other	a/	a/	a/	a/	a/	a/
Total	-0.3	-0.3	-0.4	-0.4	-0.5	-2.1
President's 1988 Budget as Estimated by CBO	1.5	1.6	1.6	1.6	1.6	
President's 1988 Budget	1.5	1.5	1.6	1.7	1.7	
CBO Reestimates	a/	a/	a/	-0.1	-0.1	-0.2

a. Less than $50 million.

Proposed Policy Changes

Changes in payments to states and localities from mineral and timber receipts account for most of the savings in this function. The President proposes to reduce the amount of federal timber and mineral receipts shared with state and local governments by calculating their share after deducting collection costs. Currently the states' and counties' share of such receipts is calculated as a percentage of gross, not net receipts. These shares vary

from program to program, but most are between 25 percent and 50 percent. CBO estimates that this proposal would result in savings to the federal government of between $200 million and $300 million per year, and five-year savings of $1.4 billion by 1992.

In addition, the President is proposing to reduce the annual basic payment to the District of Columbia from about $444 million in 1987 to $425 million a year, resulting in savings of $0.5 billion relative to the baseline over the 1988-1992 period. The President's budget also reflects a change in the way that the federal government reimburses the District for its use of water and sewer services. Currently, a lump sum appropriation is made to reimburse the District for the costs of providing these services to all federal agencies located within its jurisdiction. Under the President's proposed administrative change, all agencies would be billed for their actual usage. This proposal would have no net effect on the federal budget but would result in outlay savings of about $40 million a year in function 850. Total savings in payments to the District in this function would total $0.7 billion over the 1988-1992 period.

The General Revenue Sharing program, which previously accounted for most of the spending in this function, has expired. The CBO baseline does not include any spending for the program, and the Administration does not propose to revive it.

CBO Reestimates

CBO's outlay estimates do not differ significantly from the Administration's estimates for this function.

FUNCTION 900: NET INTEREST

MAJOR SPENDING CHANGES PROPOSED FOR BUDGET FUNCTION 900: NET INTEREST (By fiscal year, outlays in billions of dollars)

Item	1988	1989	1990	1991	1992	Cumulative Five-Year Changes
CBO Baseline	140.4	146.7	151.5	154.9	153.3	
Proposed Changes						
Debt service	-1.2	-4.0	-7.3	-11.3	-15.6	-39.4
Intragovernmental interest	0.3	0.5	0.8	1.0	1.1	3.7
Federal Financing Bank	-0.4	0.0	0.3	0.3	1.1	1.4
SBA interest	0.0	0.0	0.1	0.1	0.1	0.3
Sale of Bonneville Power Administration	0.0	0.0	0.0	0.0	0.2	0.2
Other	-0.2	-0.2	-0.2	-0.3	-0.3	-1.2
Total	-1.5	-3.6	-6.3	-10.1	-13.4	-34.9
President's 1988 Budget as Estimated by CBO	139.0	143.1	145.2	144.8	139.9	
President's 1988 Budget	139.0	141.5	139.0	134.8	122.1	
CBO Reestimates	-0.1	1.6	6.2	10.0	17.8	35.4

Proposed Policy Changes

The Administration's proposed spending cuts and revenue increases would reduce federal deficits, borrowing, and debt-service costs. The interest savings grow dramatically over time, from $1.2 billion in 1988 to $15.6 billion in 1992. By the end of 1992, debt held by the public would be almost

$300 billion lower under the President's proposed policies than in the CBO baseline.

A number of federal agencies borrow from--and pay interest to--the Treasury to finance their operations. The interest expense is recorded as a cost to the agency elsewhere in the budget and as an intragovernmental receipt within the net interest function. Changes in intragovernmental interest therefore have no net effect on the deficit. Thus, the Administration's proposals to sell old loans and curtail new lending for these programs reduce interest receipts (and increase net interest outlays) relative to the CBO baseline. The proposed sale of Rural Housing Insurance Fund loans accounts for one-half of the $3.7 billion loss in interest receipts over the 1988-1992 period. Intragovernmental interest receipts also would be reduced as a result of proposed declines in Treasury borrowing by the Federal Crop Insurance program, housing for the elderly and handicapped, and the Federal Ship Financing Fund.

The President's budget proposes a curtailment of the Federal Financing Bank's (FFB) lending activity. By the end of 1992, total FFB loans outstanding are projected to be $141 billion under the President's proposals, compared with $154 billion in the CBO baseline. This difference reflects sales of existing loans as well as sharply decreased future lending. As a result, interest receipts from the FFB are lower than in the CBO baseline--differing only slightly in 1988, but by $1.1 billion in 1992.

Two other proposed asset sales would also affect net interest. Sales from the loan portfolios of the Small Business Administration (SBA) would reduce interest receipts by $0.3 billion over the 1988-1992 period. The proposal to sell the Bonneville Power Administration (BPA) in 1991 results in a loss of interest receipts to the Treasury from BPA's borrowing. The loss is $0.2 billion in 1992. The proceeds from these proposed sales are shown in budget functions 370 and 450 (for SBA), and 950 (for Bonneville).

Other proposals result in small changes in net interest. These include moving the FFB surplus account (loan servicing fees less administrative costs) from general government (Function 800) to net interest and increasing the FFB lending premium from one-eighth of a percentage point to one-half of a percentage point.

CBO Reestimates

Differences in interest rate assumptions lead to a $40 billion reestimate of the President's net interest outlays over the five-year period. These reestimates range from $2.5 billion in 1988 to $15 billion in 1992.

Another $19 billion in reestimates over the five-year period results from higher deficits than those contained in the President's budget. Because of other reestimates to revenues and outlays, CBO projects that federal government borrowing needs would be higher than those forecast by the Administration. Additional interest costs from this borrowing grow from $1.1 billion in 1988 to $5.8 billion in 1992.

The remaining CBO reestimates to the net interest function reduce outlays by $23.7 billion over the 1988-1992 period. The largest of these reduces outlays for net interest on the public debt by $11 billion in 1988 through 1992. CBO estimates lower interest costs than the Administration for two major components of the public debt: savings bonds and debt issued to federal government revolving funds. In November 1987, the first group of savings bonds will reach maturity under a market-linked approach inaugurated in late 1982. The switch will make savings bonds accruals more erratic from year to year. CBO's estimates reflect these swings in accruals. The Administration smooths these fluctuations, but in doing so apparently overstates the effective interest rate. The Administration also overstates the current interest rate on public debt securities held by federal government revolving funds such as the deposit insurance funds.

A third downward reestimate for net interest on the public debt stems from different assumptions about means of financing. CBO assumes that the Treasury will borrow less than the full amount of the deficit each year, because it makes explicit assumptions about other means of financing (such as interest accrued but not paid, and issuance of special Federal Deposit Insurance Corporation notes in lieu of cash). Finally, offsetting part of these downward reestimates, CBO makes different assumptions about the mix of Treasury financing. The Administration assumes that roughly half of marketable borrowing will be in short-term Treasury bills, although this would imply rapid escalation in weekly auctions and differs from Treasury's current practice. CBO assumes much greater reliance on medium- and long-term instruments, which carry somewhat higher interest rates.

The largest of the remaining reestimates increases interest from the FFB. Two factors account for most of the increase. First, the Administration's budget omits estimates for prepayment penalties associated with loan asset sales that were mandated by the Omnibus Budget Reconciliation Act of 1986 (Public Law 99-509). Since these penalties are counted as interest, they add $1.6 billion to FFB interest receipts in 1987. Over the 1988-1992 period, penalties associated with proposed loan asset sales in the Administration's budget add $2.8 billion to FFB interest receipts. Since these penalties are paid by government agencies, they are offset within other

budget functions and have no effect on the deficit. Second, the budget includes a proposal to allow foreign military credit sales borrowers to prepay their FFB debt without penalty in 1988 and later years. CBO excludes this proposal (see the function 150 analysis in Chapter V) and therefore projects higher FFB interest receipts.

CBO's estimate of interest paid on IRS refunds is lower than the Administration's, chiefly because of lower expected corporate tax refunds. Other reestimates reflect different projections of interest receipts from Treasury's tax and loan accounts at commercial banks and from intragovernmental interest. The latter are offset in other budget functions and have no net effect on the deficit.

FUNCTION 920: ALLOWANCES

MAJOR SPENDING CHANGES PROPOSED FOR BUDGET FUNCTION 920: ALLOWANCES (By fiscal year, outlays in billions of dollars)

Item	1988	1989	1990	1991	1992	Cumulative Five-Year Changes
CBO Baseline	0.9	3.3	5.7	8.6	11.6	
Proposed Changes						
Civilian agency pay raises	-0.6	-1.5	-2.5	-4.0	-5.5	-14.0
Davis-Bacon and Service Contract reforms	-0.1	-0.1	-0.2	-0.2	-0.2	-0.8
Credit reform initiative	-1.3	-0.6	0.9	2.2	3.6	4.8
Federal share of employee health premiums	-0.1	-0.2	-0.2	-0.3	-0.3	-1.1
Productivity savings	--	-0.2	-0.5	-0.8	-1.0	-2.5
Total	-2.1	-2.6	-2.5	-2.9	-3.4	-13.6
President's 1988 Budget as Estimated by CBO	-1.2	0.7	3.2	5.7	8.2	
President's 1988 Budget	-0.8	0.5	2.8	4.9	7.1	
CBO Reestimates	-0.4	0.2	0.5	0.8	1.1	2.1

Proposed Policy Changes

The allowances function contains several proposals affecting pay levels, benefit contributions, and other personnel practices concerning employees of civilian agencies. It also includes the President's credit reform initiative and reform of the Davis-Bacon and Service Contract Acts.

Civilian Agency Pay Raises. The Administration is proposing to limit pay rate increases to 2 percent in 1988 and 3 percent in 1989 through 1992 for white- and blue-collar civilian employees, effective in January for white-collar employees and at various times throughout the year with a three-month delay for blue-collar employees. The Administration, however, requests only one-half of the amount necessary to fund the proposed increase in 1988. Thus, civilian agencies would be required to pay for 50 percent of the 1988 pay raise from funds appropriated for other purposes. On the other hand, the Administration requests funding of the total cost of the 1988 pay raise for all Department of Defense (DoD) employees, shown in the national defense function (050). Coast Guard and Public Health Service officers would receive the same increases as DoD uniformed military employees: 4 percent in 1988, 4.3 percent in 1989, 4.6 percent in 1990, 4.5 percent in 1991, and 4.2 percent in 1992, effective each year in January.

The CBO baseline assumes pay rate increases equal to the annual rate of projected growth in private-sector pay: 3 percent in January 1988, 4.8 percent in October 1988, 5.2 percent in October 1989, 5.8 percent in October 1990, and 5.7 percent in October 1991. CBO estimates that the Administration's proposal would reduce outlays by $0.6 billion in 1988 and by a total of $14.0 billion in the 1988-1992 period, compared with the CBO baseline.

Reform of Davis-Bacon and Service Contract Acts. The Davis-Bacon and Service Contract Acts require that prevailing local wages be paid to workers hired by contractors involved in all federally funded or assisted projects above certain thresholds--$2,000 for Davis-Bacon and $2,500 for Service Contract. The Administration proposes to increase the minimum contract size subject to the requirements of the Davis-Bacon and the Service Contract Acts. The new thresholds would be $1 million for Department of Defense contracts and $100,000 for other agencies. These increases would allow contractors on smaller projects to pay lower wages in some cases. This change would result in lower contract costs, reducing outlays by about $0.1 billion in 1988 and by a total of $0.8 billion in the 1988-1992 period.

Credit Reform Initiative. The Administration is proposing to change the way federal credit programs are treated in the budget. At present, loan disbursements are scored as outlays and loan repayments are recorded as offsetting collections. Loan guarantee commitments appear in the budget only when a default occurs, and loan guarantee fees are treated as offsetting collections. Under the Administration's proposal, the budget would reflect the economic cost of these credit activities--the present value of the sub-

sidy, if any--in the year in which the direct loan or loan guarantee is made. The Administration's plan would reduce outlays by $1.3 billion in 1988 and by $0.6 billion in 1989, but would increase spending in later years. Chapter VII provides a further discussion of the Administration's credit proposals.

Government Contribution for Federal Employees Health Benefits (FEHB). The Administration is proposing to lower the government's share of its employees' health insurance premiums by changing the formula used to determine contributions. The proposal would tie the government's share of costs to the average of premiums in all FEHB plans rather than--as under current law--to the average of premiums in only the six largest, high-option plans. This proposal would shift some of the government's share of health insurance costs to its employees and reduce outlays by $0.1 billion in fiscal year 1988 and by a total of $1.1 billion in the 1988-1992 period. About one-third of the total savings of this plan relates to lower government contributions for annuitants and is shown in the health function (550).

Productivity Savings. The Administration is proposing several changes in personnel policies which, it argues, would increase productivity. These proposals include replacing the virtually automatic within-grade increases for federal employees with merit increases based on employee performance and simplifying the pay and personnel systems. These proposals, which would take effect in fiscal year 1989, would reduce outlays by $0.2 billion in 1989, and by a total of $2.5 billion in the 1989-1992 period.

CBO Reestimates

Under CBO reestimates of the Administration's civilian agency pay raise proposals, outlays would be lower by $0.3 billion in 1988, but would increase thereafter, for a total increase of $2.3 billion in the 1988-1992 period. These outlay variations result from differences in estimates of payroll, the cost of the Quadrennial Commission pay raises for Judges, Members of the Congress, and other executives, and other estimating factors.

The budget omits the savings that result from the proposed changes in the Service Contract Act. Including CBO's estimates of these savings and of Davis-Bacon savings lowers projected outlays by $0.1 billion in 1988 and by a total of $0.2 billion in the 1988-1992 period. Other CBO outlay estimates do not differ significantly from the Administration's estimates for this function.

FUNCTION 950: UNDISTRIBUTED OFFSETTING RECEIPTS

MAJOR SPENDING CHANGES PROPOSED FOR BUDGET FUNCTION 950: UNDISTRIBUTED OFFSETTING RECEIPTS

(By fiscal year, outlays in billions of dollars)

Item	1988	1989	1990	1991	1992	Cumulative Five-Year Changes
CBO Baseline	-40.4	-42.9	-45.4	-48.2	-51.0	
Proposed Changes						
Sale of power marketing administrations a/	0	-1.5	-2.3	-5.1	-3.7	-12.6
Sale of Naval Petroleum Reserves a/	-2.2	-0.7	0	0	0	-3.0
Auction of unassigned spectrum	-0.6	0	0	0	0	-0.6
Sale of Amtrak assets	0	0	0	0	0	0
Employer share, employee retirement	-0.4	-0.2	-0.2	0.2	0.6	b/
Total	-3.2	-2.5	-2.5	-4.9	-3.1	-16.2
President's 1988 Budget as Estimated by CBO	-43.5	-45.4	-47.8	-53.1	-54.0	
President's 1988 Budget	-45.4	-45.8	-48.5	-54.0	-55.6	
CBO Reestimates	1.9	0.4	0.7	0.9	1.6	5.5

a. The receipts from the proposed sale of the power marketing administrations and the Naval Petroleum Reserves are shown in function 950. Outlays in function 270 would increase, relative to the baseline, after the proposed asset sales, because these assets would no longer generate receipts for the government.

b. Less than $50 million.

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Proposed Policy Changes

The budget includes a number of measures that would increase undistributed offsetting receipts by about $16 billion over the 1988-1992 period relative to CBO's baseline. The President is proposing to sell the government's interests in the power marketing administrations (PMAs) and the Naval Petroleum Reserves (NPRs). In addition, the President proposes using auctions to allocate the rights to use unassigned communications frequencies, and plans to sell some or all of the assets of Amtrak. CBO estimates that these asset sales, if implemented, could bring in over $16 billion in receipts to the government by 1992, though lost income that would have been generated by some of these assets would total $2.9 billion over the 1988-1992 period. In addition, the President is proposing to increase certain agency contributions for employee retirement, but because of the offsetting effects of assumptions about pay raises, there is no net effect on outlays in this function over the five-year period.

Power Marketing Administrations. Starting in 1989, the President recommends selling the five power marketing administrations (PMAs) in the Department of Energy: the Alaska PMA, the Bonneville Power Administration (BPA), the Southeastern PMA, the Southwestern PMA, and the Western PMA. These agencies sell and transmit the electricity produced at federal dams owned and operated by the Corps of Engineers and the Bureau of Reclamation. The Administration believes that marketing electricity is no longer a federal responsibility, and that states, localities, and private management could be more responsive to customer needs. CBO estimates that the government could receive about $12.6 billion from such sales by 1992, which would be partially offset by lost income (in function 270) of about $0.9 billion from 1989 through 1992 and additional amounts thereafter. The net five-year impact of this proposal is an estimated outlay reduction of $11.7 billion.

Potential receipts from selling the PMAs are very uncertain, because of the differing values of these assets to prospective buyers, and because of the uncertain impact of the sale on the federal tax liability of potential buyers. Although the President's estimate of $14 billion in sales receipts falls within a range of possible values, CBO estimates that the receipts are likely to be lower--about $12.6 billion by 1992--based on an analysis of projected future income of the PMAs. This estimate assumes that purchasers would be able to set electric rates to their customers at competitive levels, and that purchase prices would reflect this expectation.

Naval Petroleum Reserves. The government owns approximately 78 percent of the Elk Hills oil field, known as NPR-1, and 100 percent of the Teapot Dome oil field, known as NPR-3. Selling these interests is estimated to increase federal receipts by $3 billion by 1989. The selling price is highly dependent on the timing of these sales and the private market's expectations of future oil prices. Selling the reserves would reduce net income from oil sales by about $2 billion over the 1989-1992 period. CBO estimates the net five-year impact of this sale to be $1 billion in outlay reductions.

The budget includes receipts from the sale of the NPRs of $2.5 billion in 1988 and $0.8 billion in 1989, for a total of $3.3 billion. CBO estimates receipts of $2.2 billion in 1988 and $0.7 billion in 1989, for a total sale amount of about $3.0 billion. The primary reasons for the reestimates are that CBO assumes lower oil prices and a higher market discount rate than the Administration.

Auction of the Unassigned Spectrum. The President proposes giving the Federal Communications Commission the authority to use auctions, rather than the current methods of hearings or lotteries, in assigning licenses for use of communications frequencies that are currently not assigned. Such auctions are expected to generate $0.6 billion in receipts in 1988.

Sale of Amtrak. The President's budget includes a proposal to sell all or part of the assets of Amtrak, with estimated receipts to the government of $1 billion. CBO is unable to estimate the effect of this proposal, because it has not been clearly defined. Because of the complexity involved in disposing of Amtrak's assets, it may be difficult or impossible to obtain the receipts included in the President's budget in 1988. Furthermore, it is unclear to what extent the federal government could generate substantial receipts from the disposal of assets while maintaining Amtrak operations, or whether such operations would be continued at all in the absence of government subsidy payments (see function 400). Also, there is no apparent ready buyer for Amtrak's assets. Therefore, no savings are included in CBO's estimate of the budget.

Employer's Share of Employee Retirement. Agency contributions to employee retirement programs are intragovernmental payments, which are paid out of the individual program accounts and recorded as offsetting receipts in this function. Several proposals in the budget would increase agency payments for employee retirement, but offsetting reductions from the CBO baseline, resulting from the President's pay proposals, would outweigh increases by 1991 and 1992.

The President would gradually increase U.S. Postal Service payments for Civil Service Retirement until payments equal the full government share of retirement costs. Social Security and Medicare coverage would be expanded to include inactive duty earnings for Armed Forces reservists. Military personnel strength would also rise under the President's request. All of these proposals would increase agency payments into various employee retirement programs by a total of $4.7 billion over the 1988-1992 period. The President, however, requests lower civilian pay raises each year and lower military pay raises after 1988 than in the CBO baseline. Because agency retirement contributions are based on employee pay levels, the lower pay raises would reduce these agency payments relative to the baseline. As a result, the employer share of employee retirement would be a total of $0.8 billion above the baseline over the 1988-1990 period, but $0.8 billion lower in the two-year period 1991-1992.

CBO Reestimates

The President's budget projects receipts from the Outer Continental Shelf (OCS) that are $3 billion greater than those estimated by CBO over the 1988-1992 period. The budget includes higher receipts because it assumes that the Supreme Court will rule in favor of the federal government in a dispute with Alaska over escrowed OCS receipts and because it assumes higher oil and gas production and prices. CBO assumes that the escrowed OCS receipts would be split evenly between Alaska and the federal government. As discussed earlier, CBO includes no estimate of receipts from the sale of Amtrak assets, and projects lower receipts from the sale of the PMAs (a difference of $1.4 billion) and the Naval Petroleum Reserves (a difference of $0.3 billion).

CHAPTER VI

THE ADMINISTRATION'S CREDIT PROPOSALS

The President's 1988 budget proposes three federal credit initiatives. First, for many federal credit programs, it recommends reductions in the level of activity and in the subsidy provided per dollar loaned or guaranteed. Second, it endorses a change in federal credit accounting and management practices that would highlight the subsidy cost of new federal loan obligations and guarantee commitments in the unified budget. Third, it would expand the pilot sale of existing loan assets proposed in the 1987 budget. These recommendations are made in the belief that many credit subsidies are larger than originally intended; that the federal role in credit markets is too pervasive; that the cost of federal credit is largely hidden; and that federal credit programs offer opportunities for deficit reduction.

THE ADMINISTRATION'S CREDIT BUDGET

The credit budget is a statement of direct loan obligations and guaranteed loan commitments. It measures the authority of federal agencies to make new offers of federal credit. In contrast to the unified budget that measures federally assisted credit net of repayments, the credit budget reports credit authority on a gross basis. The aggregate effect of the President's proposals for credit activity, as reestimated by CBO, would be to reduce new federal direct loan obligations in 1988 by $4.5 billion relative to the CBO baseline (see Table VI-1). Over five years, the decrease would total $40.6 billion. CBO also estimates that new guaranteed loan commitments would decline by $31 billion and $198.5 billion in 1988 and the 1988-1992 period, respectively.

A complete, detailed discussion of the President's proposed changes for credit programs by major function appears in Chapter V. Only the most significant of these changes are noted here and summarized in Table VI-2.

Commodity Credit Corporation

Farmers may borrow the support-price value of their crops by putting up the crops as collateral. The Administration proposes to reduce crop target prices 10 percent per year beginning with 1988 crops. CBO projects this

would cause farmers to reduce production of wheat, feed grains, cotton, and rice compared with baseline levels. Lower crop production would tend to reduce farmer use of price support loans by an estimated $7.1 billion below the CBO baseline over five years.

Agricultural Credit Programs

Agricultural credit programs administered by the Farmers Home Administration include both direct loans and guarantees to fund farm operations, real estate purchases, and recovery from natural disasters. The President proposes a change in structure by reducing the level of direct loans for these purposes, the estimated subsidy cost of which in 1986 was more than 12 percent of the loan amount, and by increasing the use of guarantees, the

TABLE VI-1. THE ADMINISTRATION'S CREDIT BUDGET AS ESTIMATED BY CBO (By fiscal year, in billions of dollars)

	1988	1989	1990	1991	1992	Cumulative Five-Year Total
Direct Loan Obligations						
CBO Baseline	35.5	34.7	34.0	33.7	33.7	171.6
Proposed Changes	-4.5	-7.0	-8.5	-9.6	-11.0	-40.6
President's Credit Budget Reestimated by CBO	31.0	27.7	25.5	24.1	22.7	131.0
Guaranteed Loan Commitments						
CBO Baseline	149.5	151.0	158.9	166.5	172.6	798.5
Proposed Changes	-31.0	-38.1	-41.1	-43.4	-44.9	-198.5
President's Credit Budget Reestimated by CBO	118.6	112.9	117.8	123.1	127.7	600.1

SOURCE: Congressional Budget Office.

TABLE VI-2. MAJOR PROPOSED CREDIT PROGRAM CHANGES, 1988-1992 (By fiscal year, in billions of dollars)

Major Program	1988	1989	1990	1991	1992	Cumulative Five-Year Total
Direct Loan Obligations						
CBO Baseline	35.5	34.7	34.0	33.7	33.7	171.6
Proposed Changes						
Rural Electrification	-1.6	-1.8	-2.0	-2.1	-2.2	-9.7
Commodity Credit Corporation	0.0	-0.8	-1.5	-2.1	-2.6	-7.1
FmHA Agricultural Credit	-0.3	-1.1	-1.1	-1.1	-1.3	-4.9
FmHA Rural Housing	-2.1	-2.2	-2.3	-2.4	-2.5	-11.6
FmHA Rural Development	-0.2	-0.4	-0.5	-0.5	-0.5	-2.1
Housing for Elderly or Handicapped	-0.5	-0.6	-0.7	-0.7	-0.7	-3.2
Rural Telephone Bank	-0.1	-0.1	-0.2	-0.2	-0.2	-0.7
Other	0.5	0.1	-0.2	-0.5	-1.0	-1.3
Total	-4.5	-7.0	-8.5	-9.6	-11.0	-40.6
President's Credit Budget Reestimated by CBO	31.0	27.7	25.5	24.1	22.7	131.0
Guaranteed Loan Commitments						
CBO Baseline	149.5	151.0	158.9	166.5	172.6	798.5
Proposed Changes						
Rural Electrification	1.0	1.3	1.6	1.6	1.6	7.1
Small Business Administration	-0.1	-0.2	-0.4	-0.5	-0.6	-1.9
Commodity Credit Corporation	-2.0	-2.0	-2.0	-2.0	-2.0	-10.0
Guaranteed Student Loans	-1.7	-1.5	-1.5	-1.5	-1.5	-7.8
Community Development	-0.2	-0.2	-0.2	-0.2	-0.2	-0.8
Federal Housing Administration	-24.7	-33.2	-36.0	-38.0	-39.2	-171.1
Veterans Administration	-2.3	-2.1	-2.3	-2.5	-2.7	-11.9
Other	-0.9	-0.2	-0.3	-0.3	-0.3	-2.1
Total	-31.0	-38.1	-41.1	-43.4	-44.9	-198.5
President's Credit Budget Reestimated by CBO	118.6	112.9	117.8	123.1	127.7	600.1

SOURCE: Congressional Budget Office.

subsidy cost of which is estimated at 5.5 percent of principal. Agricultural Credit Insurance Fund direct loans would decline a total of $4.9 billion, relative to the baseline, by 1992.

Rural Housing and Rural Development

These Farmers Home Administration loan programs would be terminated in 1988. Rural housing loans would be replaced by housing vouchers like those used in urban housing programs. These two terminations account for $13.7 billion or one-third of the total five-year reduction in federal direct loans proposed by the President.

Rural Electrification Administration

Lending by REA would be phased down in 1988 and 1989 and terminated in 1990. Both the direct loan and 100 percent guarantee programs would be replaced by a 70 percent guarantee on the principal amount advanced by private lenders. To accelerate repayments on existing federal loans disbursed by the Federal Financing Bank, borrowers would be permitted to prepay without penalty. They would be offered a discount on prepayments if they agreed not to seek further assistance from REA. The effect of this shift is evident from the $9.7 billion decline in REA direct loans relative to the baseline and in the projected $7.1 billion increase in REA guarantees.

Housing for the Elderly or Handicapped

These direct construction loans would be reduced $500 million to $700 million per year. Some of the reduction in this program would be replaced by housing vouchers provided directly to beneficiaries.

Small Business Administration

Credit assistance to small business would be shifted from direct loans toward loan guarantees. Guarantee fees would be increased, and the percent of principal guaranteed would be reduced gradually from 90 percent to 75 percent by 1992. CBO estimates that loan guarantee levels would be reduced by the Administration by $1.9 billion over five years.

Guaranteed Student Loans

Under the Administration's proposals, borrowers would pay a 9 percent, one-time, up-front origination fee, instead of the 5 percent fee now paid. The higher fee is intended to cover default losses in the program. In addition, the federal payment of interest on the loan during in-school, deferment, and grace periods would be ended. The interest subsidy paid by the government to lenders would also be reduced. Restrictions on the amount that can be borrowed by students would be dropped, however. CBO projects that the net effect of this change would be to reduce GSL originations by $1.5 billion to $1.7 billion per year.

Federal Housing Administration Mortgage Insurance

Terms on this insurance would be more restrictive. The insurance premium would be increased from 3.8 percent of the mortgage to 5 percent. Families with annual incomes over $40,000 would be required to make a 5 percent down payment to qualify for mortgage insurance. Only mortgages on primary residences would be eligible. No closing costs or insurance premiums could be included in the mortgage. CBO estimates that such changes would reduce FHA insurance commitments by $24.7 billion in 1988, increasing to $39.2 billion per year in 1992. This decline accounts for more than 75 percent of the total reduction in guarantees proposed by the President.

VA Mortgage Guarantees

Origination fees for VA mortgages would be increased from 1 percent to 2.5 percent of the mortgage. This increase is projected to reduce VA guaranteed mortgages by $2.1 billion to $2.7 billion per year in the 1988-1992 period.

CREDIT REFORM

The Administration's plan would improve the budgetary display of new credit activity by reporting credit subsidy costs in the agency budget accounts and the associated cash flows for new loans and guarantees in the account of a new revolving fund in the Treasury. Under current accounting practices, credit programs give rise to outlays when loans are disbursed and to offsetting collections or receipts when repayments are received. Thus, an agency loan account may show net outlays of zero--if repayments equal dis-

bursements--in a year in which a large volume of deeply subsidized loans are originated.

Further, under current practice, new loan guarantees are shown as having no outlay costs until a guaranteed loan goes into default and federal disbursements are required. If fees are charged for loan guarantees, the first-year effect of issuing new guarantees is to reduce outlays since these fees are recorded as offsetting receipts. Net outlays for guarantees now shown in the budget consist of disbursements to honor commitments issued in previous years, less fees and recoveries on defaulted loans.

To reflect the costs of current activity more accurately, the Administration proposes to estimate and recognize in the agency loan accounts the present value of the future subsidy when a new loan is obligated or a new guarantee is committed. That is, instead of reporting an outlay cost of $100 when a $100 loan is disbursed, the Administration would show as a credit cost only that portion of loan funds that constitutes a subsidy. This subsidy cost is approximately equal to the present value of the difference between the payments a borrower makes with federal assistance and the payments made by that borrower in a fully private transaction. Similarly, in the case of a guaranteed loan, rather than show an outlay cost of zero when commitments are issued, the Administration would show the estimated present value of future costs of this commitment.

To achieve the substitution of subsidy cost for the current period cash flows of credit transactions in agency loan accounts, the President would create a new federal revolving fund in the Treasury. Agencies operating federal credit programs would request annual appropriations equal to the subsidy to be provided by new loan obligations and guarantee commitments. As agencies originated loans and issued guarantee commitments, they would pay from these appropriations the estimated subsidy value of those credits to the central revolving fund. The central fund would disburse loans and make guarantee payments. It would finance these outlays with subsidy payments received from the agencies and with borrowing from the Treasury.

Subsidy cost is defined as the additional payments a borrower would have had to make for a fully private, rather than a government-assisted, loan. The size of the subsidy can be estimated either by sampling market interest rates and performing the necessary calculations or, more directly, by selling loans and reinsuring guarantees with private insurers. For loan sales and reinsurance, the subsidy cost is the government's loss on the transaction; for loans, the amount advanced less the sale price; for guarantees, the insurance fee paid to the insurer less the fee collected by the government from the borrower.

The Administration proposes that subsidy cost estimates be obtained both by calculation and by sales and reinsurance. Loans that could be readily sold would be marketed to investors. Where private credit insurance is available, the government would reinsure its risk. For loans regarded as unsuitable for sale, such as those to foreign countries, and for uninsurable guarantees, the central fund would estimate the subsidy and charge the agencies that amount.

Loans already held by government and existing guarantees would not be transferred to the new revolving fund. Repayments from existing loans would be credited to the original disbursing accounts, which would also retain responsibility for honoring all currently outstanding guarantees. In order to effect a complete substitution of subsidy cost for net cash flows in the credit agency loan accounts, however, these flows from the old loan and guarantee portfolio should not be permitted to enter the agency accounts. This shortcoming of the Administration's proposal is discussed below.

Effect of Credit Reform on the Budgetary Cost of Credit Assistance

The effect of reallocating credit costs can be shown using actual cash flows and estimated subsidy costs for 1986. Table VI-3 shows the effects on the accounts of the credit agencies and the new revolving fund of implementing the Administration's proposal in that year. It is assumed in Table VI-3 that CCC price support direct loans--which are actually commodity purchases--have been excluded from credit and reclassified as purchases of goods. (The results shown in Table VI-3 would be somewhat different if the Administration's plan had been instituted before 1986. For example, "old" repayments in 1986 would differ if the plan had been put into effect in, say, 1983.)

The new system would highlight the subsidy cost of credit, or $16.9 billion, in the agency accounts. This amount is an increase of $3.3 billion from the $13.6 billion reported under current budgetary treatment. Note that total outlays for all credit agencies and the new revolving fund combined are the same as the net outlays for credit currently attributed to the credit agencies. Notice, too, that the credit agencies will continue to show cash flows from old loans and guarantees ($6.3 billion in 1986). Presumably, the detailed proposal from the Administration (due in March) will address the need to prevent these flows from being combined with subsidy cost. If such a separation is not achieved, the subsidy cost concept will be muddied by these cash flows. In time though, as the old loans mature and existing guarantees expire, this problem will disappear and the credit agency

accounts will consist solely of subsidy cost payments. At that point, guarantee disbursements and repayments from outstanding loans will appear only in the revolving fund accounts.

TABLE VI-3. THE REALLOCATION OF CREDIT COSTS ACROSS AGENCY AND NEW REVOLVING FUND ACCOUNTS UNDER THE PRESIDENT'S CREDIT REFORM PROPOSAL, FISCAL YEAR 1986 (In billions of dollars)

Current Budgetary Treatment	
Credit Agencies	
Disbursements for loans	22.5
Repayments and guarantee disbursements (net)	-6.3
Guarantee fees	-2.6
Net Cash Outlays	13.6
Credit Reform Proposal	
Credit Agencies	
Subsidy cost paid to the revolving fund	
For new direct loans	8.9
For new guarantees	8.0
Subtotal, subsidy cost	16.9
Repayments from old loans and disbursements for old guarantees (net)	-6.3
Subtotal, credit agencies net outlays	10.6
Central Revolving Fund	
New disbursements for loans	22.5
Subsidy fees received	-16.9
Guarantee fees collected	-2.6
Subtotal, revolving fund net outlays	3.0
Net Outlays	13.6

SOURCE: Congressional Budget Office.

NOTE: Excludes CCC price support direct loans from credit accounts.

Table VI-4 shows the relationship between estimated subsidy cost and net cash outflows in recent years. Subsidy cost is more stable over time than net cash outflow. In addition, subsidy cost was less than cash outflow for credit in 1984 and 1985.

Effect of Credit Reform on the Deficit

The President's proposal would not affect the definition of the unified deficit. The size of the deficit would be affected, however, to the extent the President proposes selling new loans and reinsuring guarantees. Under its credit reform plan, the Administration has proposed to realize net cash inflows of $1.8 billion from the sale of newly originated loans and to pay out guarantee reinsurance premiums of $0.5 billion in 1988. If these plans are realized, credit reform will reduce the deficit by $1.3 billion in 1988.

The Administration's credit reform proposal would improve the budgetary representation of new loans and guarantees by substituting subsidy cost in the agency accounts for the current period cash flows associated with these transactions. This change would implement the recom-

TABLE VI-4. CASH OUTFLOW AND ESTIMATED SUBSIDY COST
(By fiscal year, in billions of dollars)

	1984	1985	1986
New Loan Disbursements	36.7	39.4	22.5
Repayments Received	-17.4	-16.4	-16.4
Outlays for Guarantees	8.1	9.9	10.7
Recoveries on Defaults	-0.3	-0.4	-0.6
Guarantee Fees Collected	-1.4	-1.5	-2.6
Net Cash Outflow	25.7	31.0	13.6
Estimated Subsidy Cost			
Direct loans	9.1	10.0	8.9
Guaranteed loans	7.0	6.3	8.0
Total	16.1	16.3	16.9

SOURCE: Congressional Budget Office.

NOTE: Cash flows calculated from historical budget data. Subsidy cost obtained from Office of Management and Budget directly, or indirectly through the use of the OMB subsidy model.

mendation of the President's Commission on Budget Concepts to include only the subsidy elements of federal loans in credit agency accounts. The rationale which justifies this change also suggests that the budget deficit should not be affected by repayments of "old loans" or cash inflows from loan asset sales. That is, subsidy cost can be justified as a better measure than incidental cash flows because it properly focuses on the government's loss on credit transactions. Similarly, one can argue that a deficit intended to measure the change in the government's financial condition should not be affected by receipt of anticipated loan repayments or the acceleration of such repayments through loan asset sales. In the President's budget for 1988, both loan asset sales and loan repayments contribute to a lower deficit. As loan sales grow, their importance for deficit reduction, as currently measured, increases.

One means of immunizing budget outlays and the deficit from the effects of repayments and loan sales would be to reclassify all of these cash flows as "below the line" means of financing the deficit. Under current conventions, the deficit (outlays minus receipts) is considered to be financed by changes in Treasury balances, changes in checks outstanding, seigniorage on coins, and borrowing from the public. The "below the line" means of financing portion of the budget could be defined also to include all cash flows associated with federal credit programs. The effects of such a change are illustrated with budget data for 1984, 1985, and 1986 in Table VI-5. (The data in Table VI-5, as well as VI-3 and VI-4, differ from published figures in that Commodity Credit Corporation price support loans have been excluded from credit programs.)

To move credit cash flows below the line, the amount of credit subsidy cost, loan repayments, and loan sale proceeds must be added to the unified deficit, and disbursements must be subtracted. The reason for making these adjustments is to include subsidy cost in outlays and the deficit but to remove repayments and loan sales receipts which have been inappropriately included as offsetting collections. To make sense of the entries in the means of financing part of the budget, note that the subsidy cost entry does not correspond to a cash outlay yet--unless the loans are sold or the guarantee reinsured. It is an accounting entry reflecting an estimate of a future subsidy's present value. Thus, the subsidy cost which is included in the current period deficit is also a means of financing that current period deficit. Repayments provide a positive means of financing, but disbursements add to financing requirements and, therefore, are entered with a negative sign. In Table VI-5, all repayments disbursements, fees, and recoveries are consolidated into net credit cash flows. The negative sign means that outflows for credit exceeded inflows. The other financing entries are currently defined as means of financing.

This accounting change would reduce the deficit in 1984 and 1985, but raise it in 1986. As loan asset sales increase in 1988 and beyond, the procedure would also result in higher deficits than those recorded using existing definitions, because it would not permit loan asset sales to reduce the deficit. Since the resulting deficits could be quite different than under current budgetary practice, such an accounting change might necessitate revision of the deficit targets in the Balanced Budget Act.

PORTFOLIO LOAN SALES

In addition to selling new loans as a part of credit reform, the Administration proposes to expand the pilot loan sale program from a 1987 budget level of $8.8 billion in face value to $11.2 billion in 1988. The loans to be sold in this expanded pilot effort, listed in Table VI-6, are estimated by the Administration to have a market value of $6.9 billion. The principal and

TABLE VI-5. EFFECT ON THE BUDGET OF RECLASSIFYING CREDIT CASH FLOWS AS A MEANS OF FINANCING
(By fiscal year, in billions of dollars)

	1984	1985	1986
Cash-based Deficit	185.3	212.3	220.7
Credit subsidy cost	16.1	16.3	16.9
Loan repayments (net of guarantee outlays, recoveries, and guarantee fees)	11.0	8.4	8.9
Loan sale receipts	2.5	1.5	1.6
Disbursements	-36.7	-39.4	-22.5
Adjusted Deficit	178.2	199.1	225.6
Means of Financing			
Credit subsidy cost	16.1	16.3	16.9
Net credit cash flows	-23.2	-29.5	-12.0
Changes in fund balances, checks outstanding, seigniorage	14.5	15.0	-15.6
Borrowing from the public	170.8	197.3	236.3
Total	178.2	199.1	225.6

SOURCE: Congressional Budget Office.
NOTE: Excludes CCC price support loans from credit.

TABLE VI-6. LOAN ASSETS PROPOSED FOR SALE, ADMINISTRATION PILOT PROGRAM, FACE VALUE AND PROJECTED RECEIPTS, NET OF LOST REPAYMENTS, 1987-1992
(By fiscal year, in billions of dollars)

	1987	1988	1989	1990	1991	1992
FmHA Rural Housing						
Face value	2,200	1,200	1,000	1,000	1,000	1,000
President's net receipts	1,715	830	631	603	534	534
FmHA Rural Development						
Face value	1,870	1,200	1,000	1,000	1,000	380
President's net receipts	1,000	502	306	230	149	68
Rural Electrification						
Face value	0	1,000	1,000	1,000	1,000	1,000
President's net receipts	0	653	583	513	443	373
Rural Telephone Bank						
Face value	0	500	500	200	0	0
President's net receipts	0	449	403	133	(115)	(115)
SBA Business Loans						
Face value	0	1,000	1,000	0	0	0
President's net receipts	0	140	27	(155)	(75)	(58)
SBA Disaster Loans						
Face value	600	670	670	670	670	662
President's net receipts	277	168	80	25	(21)	(61)
SBA Development Companies						
Face value	0	500	397	0	0	0
President's net receipts	0	249	220	(60)	(60)	(60)
Federal Housing Administration						
Face value	300	350	0	0	0	0
President's net receipts	217	212	(64)	(64)	(64)	(64)
HUD Rehabilitation Loans						
Face value	0	350	308	0	0	0
President's net receipts	0	35	31	(67)	(67)	(67)
HUD Community Development						
Face value	35	200	94	0	0	0
President's net receipts	21	120	9	(39)	(39)	(39)
Housing for the Elderly or Handicapped						
Face value	0	500	0	0	0	0
President's net receipts	0	444	(45)	(45)	(45)	(45)

TABLE VI-6. (continued)

	1987	1988	1989	1990	1991	1992
College Housing Loans						
Face value	983	931	59	34	0	0
President's net receipts	579	522	(101)	(118)	(139)	(139)
Higher Education Facilities						
Face value	0	142	51	33	0	0
President's net receipts	0	83	18	3	(22)	(22)
VA Vendee Loans						
Face value	800	300	300	300	0	0
President's net receipts	720	176	152	129	92	55
Export-Import Bank						
Face value	2,018	1,200	1,000	1,000	1,000	1,000
President's net receipts	1,500	312	(116)	(291)	(434)	(528)
Reclamation Loans						
Face value	0	358	0	0	0	0
President's net receipts	0	154	(10)	(11)	(13)	(13)
HHS Medical Facilities						
Face value	0	132	0	0	0	0
President's net receipts	0	38	(8)	(8)	(9)	(10)
HMO Loans						
Face value	0	97	0	0	0	0
President's net receipts	0	24	(8)	(8)	(8)	(8)
Railroad Rehabilitation						
Face value	0	583	0	0	0	0
President's net neceipts	0	206	(8)	(8)	(8)	(8)
TVA						
Face value	0	0	256	0	0	0
President's net receipts	0	0	189	(39)	(39)	(39)
Total						
Face value	8,806	11,213	7,635	5,287	4,670	4,042
President's net receipts	6,029	5,317	2,289	723	60	(246)
Net Receipts Reestimated by CBO	5,112	5,473	2,253	362	(541)	(1,303)

SOURCES: Congressional Budget Office; Office of Management and Budget.

interest forgone by the government in 1988 as a result of the sale would diminish the net deficit reduction to $5.3 billion. CBO's reestimate of the net deficit reduction in 1988 from these loan asset sales is $5.5 billion.

An additional $600 million in face value of loans would also be sold in 1988 for programmatic reasons. These sales would consist of (in face value) $329 million of GNMA tandem plan loans and $283 million of defaulted guaranteed student loans and national direct student loans. Since GNMA loans have been sold in recent years, these sales would represent the continuation of current policy. In the past, however, these loans have been sold with federal guarantees attached. Loan sales "with full recourse" to the federal government or other forms of guarantee in which the federal government retains the credit risk are not genuine sales given that the government continues to be liable for all default risk. Accordingly, OMB and CBO no longer treat such transactions as sales. The GNMA program is grandfathered for 1987. GNMA tandem sales will be treated as borrowing in 1988, the last year such transactions are projected to occur. Defaulted education loan sales are considered to be "programmatic" because they are viewed by the Administration as a part of a collection effort rather than a sale of securities.

APPENDIXES

APPENDIX A

BASELINE BUDGET PROJECTIONS

Baseline budget projections are intended to show the levels of revenues, outlays, and deficits that would occur during the next five years, assuming that budgetary policies remain unchanged. They provide a useful starting point for analyzing the changes in national priorities recommended by the President and their dollar effects on budget totals.

Both the Congressional Budget Office (CBO) and the Office of Management and Budget (OMB) prepare baseline budget projections. Under both sets of projections, the federal deficit is estimated to decline from last year's record level of $221 billion, but to remain well above the targets set by the Balanced Budget Act.

This appendix briefly discusses the budgetary outlook under unchanged policies. A month ago, CBO published its baseline projections for fiscal years 1988 through 1992. Additional information has led CBO to revise its projections slightly. The first section of this appendix summarizes the CBO projections and explains why they have changed. The second section compares CBO's projections with the Administration's own estimates of the budget under unchanged policies. The body of this report highlights the policy changes proposed by the Administration in its 1988 budget by comparing them with the CBO baseline.

THE CBO REVISED BASELINE

Under current budgetary policies, CBO projects that the federal deficit will decline slightly between 1987 and 1988 and more steeply thereafter. By 1992, the deficit in dollar terms should be half as big as in 1987; compared with the gross national product (GNP), it would be only one-third as big. Table A-1 summarizes CBO's projections of federal revenues, outlays, deficits, and debt if current policies continue. These projections are contingent on CBO's assumption of a slight pickup in economic growth from last year's sluggish rate and on continued gradual declines in interest rates. Even though the federal deficit is shrinking under current policies, it still remains stubbornly above the targets set in the Balanced Budget Act. Reaching these targets would require deficit reductions of about $63 billion in 1988 and about $100 billion a year from 1989 through 1991.

Annual estimates of federal revenues and outlays often reflect a number of one-time or special factors. In 1987, for example, CBO would project a bigger deficit were it not for planned sales of federal assets, shifts of outlays to adjacent years, and a first-year revenue gain from tax reform. But the deficit's downward trend reflects the underlying dynamics of the federal budget in the absence of policy changes. Revenues are boosted by a

TABLE A-1. BASELINE BUDGET PROJECTIONS (By fiscal year)

	1987	1988	1989	1990	1991	1992
			In Billions of Dollars			
Revenues						
Individual income	361.3	381.0	412.4	458.4	502.2	546.0
Corporate income	100.6	118.5	125.8	137.7	150.5	162.6
Social insurance	300.8	329.5	353.3	383.3	412.5	437.8
Other	71.4	71.5	70.5	71.6	73.7	76.0
Total	834.1	900.5	962.0	1,051.0	1,138.9	1,222.5
Outlays						
National defense	279.6	290.5	303.4	317.1	332.3	346.9
Entitlements	481.4	511.1	542.5	576.9	616.1	658.2
Nondefense discretionary	168.5	188.4	196.9	208.9	215.8	222.4
Net interest	133.6	140.4	146.7	151.5	154.9	153.3
Offsetting receipts	-53.1	-59.4	-63.2	-66.6	-70.5	-74.3
Total	1,009.9	1,071.0	1,126.4	1,187.8	1,248.5	1,306.4
Deficit	175.8	170.6	164.4	136.8	109.5	84.0
Debt Held by the Public	1,912.8	2,081.3	2,243.5	2,378.4	2,484.8	2,567.9

(continued)

NOTE: Totals include Social Security, which is off-budget.

combination of inflation and real economic growth. Outlays, in contrast, grow only a little faster than inflation in CBO's baseline. Net interest outlays--which contributed so powerfully to spending growth in the early 1980s--are expected to grow much more slowly, because of lower interest rates and smaller deficits.

TABLE A-1. (continued)

	1987	1988	1989	1990	1991	1992
			As a Percent of GNP			
Revenues						
Individual income	8.2	8.1	8.2	8.5	8.7	8.8
Corporate income	2.3	2.5	2.5	2.5	2.6	2.6
Social insurance	6.8	7.0	7.0	7.1	7.1	7.1
Other	1.6	1.5	1.4	1.3	1.3	1.2
Total	19.0	19.2	19.1	19.4	19.7	19.8
Outlays						
National defense	6.4	6.2	6.0	5.9	5.7	5.6
Entitlements	10.9	10.9	10.8	10.7	10.6	10.6
Nondefense discretionary	3.8	4.0	3.9	3.9	3.7	3.6
Net interest	3.0	3.0	2.9	2.8	2.7	2.5
Offsetting receipts	-1.2	-1.3	-1.3	-1.2	-1.2	-1.2
Total	23.0	22.8	22.4	22.0	21.6	21.1
Deficit	4.0	3.6	3.3	2.5	1.9	1.4
Debt Held by the Public	43.5	44.3	44.6	44.0	42.9	41.5
Memorandum:						
GNP	4,399	4,698	5,033	5,406	5,792	6,186

SOURCE: Congressional Budget Office.

CBO estimates of future federal revenues and spending for entitlement programs--such as Social Security--and of offsetting receipts are based on the assumption that laws now on the statute books remain unchanged. Spending for defense and nondefense discretionary programs--those that are funded through the appropriations process--is estimated by assuming that 1987 appropriations remain constant in real terms (that is, with increases sufficient only to offset inflation). CBO's January 1987 report, *The Economic and Budget Outlook: Fiscal Years 1988-1992*, describes in detail the concepts and assumptions used in the baseline.

During the past month, CBO has revised its baseline budget projections to reflect additional information, much of which became available with the release of the Administration's budget. CBO has not changed the economic assumptions on which its projections are based. In the aggregate, these revisions are small, raising the deficit by an average of $1 billion a year from 1987 through 1992.

CBO now projects slightly higher revenues under current policies than it did earlier; the revisions amount to $0.2 billion to $0.3 billion a year from 1987 through 1989 and $1 billion to $2 billion from 1990 through 1992. Several factors account for these revisions. Social Security taxes paid by self-employed taxpayers (SECA taxes) were increased to reflect reduced estimates of allowable deductions taken by the self-employed when computing their tax liability. This revision grows from $0.4 billion in 1990 to $1.3 billion in 1992; it does not affect the early years of the projection period. Excise tax revenues were revised, for 1992 only, to reflect extension of taxes for the Hazardous Substance Response Trust Fund (Superfund) at rates in effect on their scheduled expiration date, December 31, 1991. Other small changes and reclassifications increase revenues by $0.2 billion to $0.3 billion each year.

CBO also projects somewhat higher outlays than it did one month ago, the net result of revisions to a wide variety of spending categories. CBO now estimates higher outlays for several Farmers Home Administration lending programs, and has increased its estimate of Commodity Credit Corporation (CCC) spending in most years. Spending for international affairs (budget function 150) is higher through 1990 but lower thereafter; this revision comes largely from new assumptions about the guarantee reserve fund, which covers delinquent foreign military sales loans. Under the new projections, some outlays will be lower. Medicare spending in 1988 is expected to be about $600 million lower. The Congress recently mandated schedules for the timely payment of Medicare claims, which CBO estimated would accelerate outlays in 1988. It now appears, however, that payments are already well within the requirements. Net interest outlays are lower than projected

earlier; greater interest receipts from loans and prepayment penalties are only partly offset by higher borrowing costs necessitated by other revisions.

DIFFERENCES BETWEEN CBO BASELINE AND ADMINISTRATION CURRENT SERVICES PROJECTIONS

Like CBO, the Administration projects how the federal budget would look if current tax and spending policies are continued. Also like CBO, the Administration projects that the deficit will decline as revenue growth surpasses outlay growth. But the baseline projections of the two agencies otherwise contain some significantly different features.

According to the Office of Management and Budget's current services projections, the federal deficit will decline to $174 billion in 1987, $150 billion in 1988, and $78 billion in 1992, assuming no further changes in tax law, no domestic spending changes, and a continuation of the defense buildup. CBO projects a higher deficit than the Administration in all years, especially in 1988. CBO would project still higher deficits if, like the Administration, it assumed that defense appropriations would increase faster than inflation.

Administration and CBO estimates diverge for several reasons: alternative definitions of current policy, contrasting macroeconomic forecasts, and other estimating differences (see Table A-2). Differences between the deficit projections of the two agencies are even larger than they first appear, because the Administration's figures contain built-in spending increases--for defense and a space station--that CBO's do not. CBO's more pessimistic projections stem first and foremost from its less optimistic economic outlook. (Chapter II compares the Administration and CBO economic forecasts.) CBO's estimate of outlays for a wide variety of programs in fiscal year 1988 is also higher than the Administration's. But these noneconomic factors have a much smaller effect on the deficit after 1988.

Conceptual differences arise from different interpretations of current policies. Identifying current policies is often straightforward: tax law and some spending programs (such as Social Security), for example, will continue unchanged until lawmakers rewrite their underlying provisions.[1/] In con-

1. Both CBO and the Administration extend taxes for the Airport and Airway, Highway, and Superfund trust funds at current law rates through 1992 in their current policy projections. These taxes are scheduled to expire before 1992. This assumption better approximates current policy.

trast, many spending programs receive appropriations for only one year at a time. Other programs leave wide latitude to program administrators. (In its January 1987 report, CBO documented in detail the assumptions that it uses wherever current policy requires interpretation.)

Table A-2 shows the important instances in which CBO and OMB define certain current policies differently. Defense spending is a major source

TABLE A-2. MAJOR DIFFERENCES BETWEEN ADMINISTRATION'S AND CBO's BUDGET PROJECTIONS UNDER CURRENT POLICY (By fiscal year, in billions of dollars)

	1988	1989	1990	1991	1992
Administration's Current Services Deficit	150	147	126	101	78
Major Policy Differences					
Defense	-8	-9	-14	-18	-23
CCC advance deficiency payments	5	a/	a/	a/	a/
Hospital insurance	1	1	3	5	6
Space station	a/	-1	-1	-2	-1
Civilian agency pay raises	1	1	2	3	4
Subtotal	-2	-8	-11	-12	-14
Major Economic Differences					
Benefit programs	2	5	8	14	21
Net interest b/	3	5	8	13	18
Revenues	10	10	3	-8	-23
Subtotal	14	19	19	19	17
Other Differences	8	4	a/	-2	a/
Additional Debt Service Costs	1	2	3	3	4
Total Differences	20	18	11	8	6
CBO Baseline Deficit	171	164	137	110	84

SOURCE: Office of Management and Budget and Congressional Budget Office.

a. Less than $500 million.

b. Effect of higher interest rates only.

of divergence. CBO treats defense and nondefense discretionary programs in exactly the same way: that is, it assumes that annual increases suffice to cover inflation, maintaining appropriations at constant levels in real terms. The Administration departs from this approach in the case of defense. Its current services estimates reflect defense appropriations growth of 3 percent a year over and above inflation. Thus, the Administration's current services estimates for defense outlays exceed CBO's by amounts growing from $8 billion in 1988 to $23 billion in 1992.

Another key policy difference between the Administration and CBO concerns the timing of deficiency payments to growers of wheat, feed grains, cotton, and rice. CBO assumes that the Agriculture Department will make some of these payments in advance for crops in 1988 and subsequent years, while the Administration assumes no advance payments. This difference causes CBO's estimate of Commodity Credit Corporation spending in 1988 to be $4.5 billion higher than the Administration's estimate. Advance deficiency payments were mandated by the Congress for the 1987 crop year, and were paid in three of the four previous years.

Several other major policy differences are shown in Table A-2. For the hospital insurance program, CBO assumes that reimbursement rates will increase after 1988 in keeping with an index measuring price changes for typical goods and services purchased by hospitals. The Administration assumes that reimbursement rates will increase only half as fast as this market basket index. The Administration also plans to slow down reimbursements to Medicare providers; CBO's baseline does not include this policy assumption. In its projections, the Administration includes pay raises for civilian agency government employees of 2 percent in 1988 and 3 percent annually from 1989 through 1992. CBO assumes much larger increases--averaging about five percent a year--to keep pace with projected wage growth for private-sector workers. Finally, the Administration includes full costs for a space station in its current services estimates, while CBO does not.

In the aggregate, these contrasting interpretations of current policy raise the Administration's current services estimates of the deficit above CBO's. As a result, they tend to mask large economic and technical estimating differences. As Table A-2 shows, the dominant differences stem from the two agencies' contrasting economic forecasts. CBO's less optimistic assumptions add about $15 billion to $20 billion to the deficit every year. Other estimating differences contribute substantially to the 1988 deficit but less so in later years.

APPENDIX B

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